

385

Un31u

BEFORE THE

Interstate Commerce Commission.

IN THE MATTER OF CONSOLIDATIONS AND COMBINATIONS OF CARRIERS, RELATIONS BETWEEN SUCH CARRIERS, AND COMMUNITY OF INTERESTS THEREIN, THEIR RATES, FACILITIES AND PRACTICES.

ORAL ARGUMENTS,

Washington, D. C., April 4 and 5, 1907.

Frank B. Kellogg and C. A. Secerance, for the Commission.

R. S. Lovett and John G. Milburn, for the Union Pacific Railroad Company.

Paul D. Cravath, for Otto H. Kahn and others.



Interstate commerce comm. g

INDEX.

Arguments of—	Page.
Paul D. Cravath, esq-----	5
R. S. Lovett, esq-----	41
John G. Milburn, esq-----	102
C. A. Severance, esq-----	128
F. B. Kellogg, esq-----	164

3568—07 M—1

(1)

BEFORE THE INTERSTATE COMMERCE
COMMISSION.

IN THE MATTER
OF THE
Consolidation and Combination of
Carriers, Relations between such
Carriers, and Community of In-
terest Therein, their Rates, Facili-
ties, and Practices.

WASHINGTON, D. C., *April 4, 1907—10 a. m.*

Present:

Commissioners Clements, Clark, Lane, and Harlan.

Frank B. Kellogg, esq., and C. A. Severance, esq., for
the Commission.

R. S. Lovett, esq., John G. Milburn, esq., for the
Union Pacific Railroad Company.

Paul D. Cravath, esq., for Otto H. Kahn and other
witnesses.

Commissioner CLEMENTS. Gentlemen, we are here
this morning to proceed with the further investigation
of the matter of the consolidation and combination
of the carriers, relations between such carriers, and
community of interest therein, their rates, facilities,
and practices, which has been heard heretofore at sev-
eral places; and the understanding at the last hearing
was that such further testimony as either party wanted
to present at this time would be brought in. Now

we desire to ask whether there is anything further to present on the side of the Government?

Mr. SEVERANCE. We have nothing further, your honors.

Commissioner CLEMENTS. Gentlemen, have you anything further to offer on behalf of the railroads?

Mr. LOVETT. Yes, your honor. I suppose, if your honors please, that the Commission takes knowledge of its own records and files, but I should like to read into the record, as a part of the testimony in this case, certain facts disclosed by the annual reports of the Southern Pacific Company, the Union Pacific Railroad Company, and the Oregon Short Line Railroad Company, made to this Commission. The secretary has these reports.

Commissioner CLEMENTS. Yes; we consider those matters in evidence in all these cases: but we desire that anything that is to be used shall be specifically pointed out, so that all parties may understand the purposes for which it is to be used. You may proceed.

Mr. SEVERANCE. Just one moment, Mr. Lovett. There is one thing that has been overlooked.

Mr. KELLOGG. In the testimony taken in San Francisco, Mr. Lovett was to furnish the agreement between the Atchison, Topeka & Santa Fe Railway Company, the Southern Pacific, and the Farmers' Loan and Trust Company as to the joint ownership of the Northwestern Pacific Railroad Company. There are three agreements here, and they have been furnished. I thought perhaps it would be well enough for them to be marked, so as to be identified.

Commissioner CLEMENTS. They will be filed and marked.

(The papers referred to are filed herewith, marked "Exhibits Lovett No. 1; Lovett No. 2; and Lovett No. 3.")

Mr. KELLOGG. That is all.

Mr. LOVETT. I wish to have noted on the record that the reports made to this Commission by the Union Pacific Railroad Company for the years ending June

30, 1901, and June 30, 1902, show on page 37, in the schedule of securities owned, the ownership by that company of 750,000 shares of the common stock of the Southern Pacific Company at the close of the fiscal year ending June 30, 1901, and 900,000 shares, or \$90,000,000, at the close of the fiscal year ending June 30, 1902.

I also ask that it be noted on the record that the reports of the Oregon Short Line Railroad Company for the fiscal years ending June 30, 1903, 1904, 1905, and 1906, show on page 37, in the schedule of securities owned, that that company, at the close of the fiscal year ending June 30, 1903, owned \$90,000,000, or 900,000 shares, of the common stock of the Southern Pacific Company. Also that for the fiscal year ending June 30, 1905, and the year ending June 30, 1906, the same company owned \$18,000,000, or 180,000 shares, of the preferred stock of the Southern Pacific Company.

I ask also that it be noted on the record that the same reports of the same companies for the same years—that is, the fiscal years ending June 30, 1901, 1902, 1903, 1904, 1905, and 1906, on page 7 of the report—show the common officers of the two companies, particularly the Union Pacific and Southern Pacific; that it appears from that page of those reports that J. C. Stubbs was traffic director of all these companies during all those years; that in 1901 E. H. Harriman, who was then chairman of the executive committee of the Union Pacific Railroad Company and the Oregon Short Line Railroad Company, became president and chairman of the executive committee of the Southern Pacific Company, and that has been shown in the annual reports for every year since. In 1904 it appears that he became president of the Union Pacific Railroad Company, and was prior to that and has ever since been president of the other two companies named—that is, the Southern Pacific Company and the Oregon Short Line—that also in 1904 J. Kruttschnitt became director of maintenance and operation of all of those companies.

I have prepared here a memorandum showing the common officers as taken from that.

Mr. SEVERANCE. I think it is all in the record now, is it not?

Mr. LOVETT. I do not think it is, as to the time.

Mr. SEVERANCE. Possibly not for all the years.

Mr. LOVETT. But whether it is of record or not, I want to show that these facts were shown in the annual reports filed with the Commission for all those years.

Mr. SEVERANCE. Was not Mr. Young shown, too?

Mr. LOVETT. I think he was. There were a number of common officers there at that time.

Mr. SEVERANCE. Young is not included in this. This is not supposed to include all the common officers.

Mr. LOVETT. I would like to have it appear, in addition to the statement, that Young was general auditor of all those companies. Of course, I offer those pages of the report of each of those companies which would show all the common officers.

Commissioner CLEMENTS. Whatever they show would be in evidence. This is a mere memorandum pointing out the pages referred to, as I understand it.

Mr. LOVETT. Yes. I also introduce page 5 of the record of each of those companies for the same years, showing the common officers and common directors of the various companies named; showing that for the years mentioned the majority of the directors of the Southern Pacific Company were also directors of the Union Pacific Railroad Company.

(The paper referred to was marked "Lovett No. 4.")

I also introduce a copy of the mortgage of the Southern Pacific Company to the Union Trust Company, dated August 1, 1899, which shows that every share of the capital stock of the Central Pacific Railway Company is owned by the Southern Pacific Company and pledged as collateral for that mortgage.

Commissioner CLEMENTS. That will be marked as an exhibit.

(The paper referred to is filed herewith, marked "Exhibit Lovett, No. 5.")

Mr. LOVETT. I believe that is all.

Commissioner CLEMENTS. Now, gentlemen, we have been requested, as we understand it, by Judge Lovett and other associate counsel in this case, to hear an argument, and we are also to hear that now. You may proceed in your own way and in the order which you choose.

ARGUMENT OF PAUL D. CRAVATH, ESQ.,

Representing Otto H. Kahn and other witnesses.

Mr. CRAVATH. May it please the Commission, I will say a few words regarding the Chicago & Alton transactions. I take it that the primary purpose of this Commission in investigating the so-called recapitalization of the Chicago & Alton Railroad Company was to ascertain the basis of the issue of the Chicago & Alton securities which are now outstanding and the character and value of the property which those securities represent. No one can doubt that that is a perfectly fair and legitimate subject of inquiry by the Interstate Commerce Commission.

It seems, however, that the testimony regarding these transactions has resulted in very widespread misapprehension regarding the real nature of these transactions, certainly on the part of the public and perhaps on the part of the Commission. I shall therefore discuss some of the phases of these transactions, at the risk of perhaps going beyond what would ordinarily be the scope of an inquiry by the Interstate Commerce Commission. As I shall devote most of my time to explaining what I think those Chicago & Alton transactions *are not*, it will perhaps clear the situation at the outset if I show what I believe they *are*.

There can be no doubt that one of the purposes and one of the results of the series of transactions which I shall briefly call the Chicago & Alton recapitalization was to reduce the cost to the syndicate of the 97 per cent of the Chicago & Alton stock which they had purchased for approximately \$39,000,000. There is no doubt at all that that was one of the purposes of this series of trans-

actions, and, I shall contend later, an entirely proper purpose.

There is no doubt, in the second place, that another purpose and effect of this recapitalization was to create securities the aggregate par value of which exceeded the intrinsic demonstrated value of the property at the time those securities were created. By intrinsic value I mean the cash cost or the value which could be ascertained by an appraisal of the physical property. By demonstrated value I mean the value which could be demonstrated, first, by an appraisal of the physical property, and, second, by the past achievements of the property in respect to earnings. A portion of these new securities, chiefly the common stock, as I shall point out, represented the future of the property—the added value which was expected to result, and which I believe to a great extent did result, from the application of new methods and on account of the growth of the country.

Now, if it should be the view of this Commission that such transactions—the class of transactions of which the Chicago & Alton recapitalization is, as I shall contend, a fair example—should be regulated by law, and that in the future the issue of securities under such conditions should either not be permitted or should be permitted only under the guidance of this Commission or of a proper body of public officials, I should have no quarrel. I think any fair-minded man must recognize that under existing conditions there is a call for a closer regulation of the issue of securities by semi-public corporations than has heretofore been the case. And yet we must not forget the conditions that existed when these securities were issued. I think any student of the development of American industries, and particularly of American railroads, must agree that the liberality of our laws with respect to the issue of securities and the creation of stocks and bonds has been of the utmost importance in aiding in the development of this country. I think it is very clear that had we had in this country during the past twenty-five years the strict laws which now exist in England

and in most European countries—the stricter laws which it is now proposed to enact in many States—a very substantial part of the development of our country and the development of our new industries would have been impracticable; so that the so-called vice of stock watering has been in many cases a real virtue, a real aid to the development of the country. Perhaps a lawyer in arguing a case has no right to express his views on questions of economic policy, but I for one quite agree that the time has come in the development of our country when in balancing advantages and evils the advantage would be in favor of a much stricter regulation of the issue of stocks and bonds and much greater conservatism enforced by law than has prevailed in the past in these regards. But throughout my brief discussion I shall ask you to bear in mind that we are dealing with the period which immediately followed the depression of 1893—the period of the most remarkable development in the history of our country in industries and railroads and new enterprises generally—when very different standards were being applied from those applied now, and when many things were not only permissible, but were approved, which, under existing conditions and under the conservative influences which have come from success and from our rapid development, are now regarded at least as unwise. And bear in mind, gentlemen, that these transactions took place at the height of that period of rapid development.

As I shall deal with figures, I shall follow my brief very closely; and in connection with my brief, which I have endeavored to make as short as possible, I submit a report of Mr. J. H. McClement, an eminent railroad expert, upon the Chicago & Alton recapitalization. The primary purpose of that report is to place before you in condensed form a great deal of information regarding comparative railroad finance, which I think may be of use; and I take it that on questions such as I am now discussing, which permit no formal order, you will feel free to take advantage of any information of such a character which may be made available.

At the outset let me say that there are three important

facts which seem not to be understood by the public at least, and which I think should be borne in mind throughout the consideration of these Chicago & Alton transactions.

In the first place, Messrs. Harriman, Gould, Schiff, and Stillman were not the sole owners of the 97 per cent of the capital stock of the Chicago & Alton Railroad Company which was purchased in their name in 1899. That stock was acquired for and owned by a syndicate of over a hundred individuals, firms, and corporations, which included these four men, but only to a comparatively moderate amount. So that throughout all these transactions there were over a hundred stockholders of the Chicago & Alton Railroad Company who were represented by these four men in whose name the legal title to the stock stood. The impression seems to be that these transactions were for the sole benefit of these four gentlemen.

The second fact is this: All the benefits of these transactions from beginning to end were shared equally by all the stockholders—not only by the hundred or more stockholders represented by the four gentlemen named, but also by the holders of the 3 per cent of the stock which was not sold in response to Mr. Mitchell's circular. There is no suggestion of freezing out; there is no suggestion of injustice. Every dollar of profit was divided pro rata among all the stockholders who participated in this plan.

In the third place, the impression seems to exist that your investigation has laid bare secrets; that discoveries have been made. As a matter of fact, as I think you will be convinced by a study of the record, all the transactions in question were carried through in the most public manner. Every important fact brought out by the recent investigation had been made public through reports and circulars to stockholders and other publications, and at all times since these transactions took place full information regarding the manner of issuing and distributing the securities, the prices at which they were sold, the 30 per cent dividend, and the basis of the recapitalization of the Chicago & Alton Company could

be obtained by application to any intelligent banker or broker, or by consulting Poor's Manual or any of the numerous manuals or other publications which are published for the information of investors.

In Appendix B to my brief you will find a summary of some of the publications which furnished public information regarding each step in the transaction. For instance, take the third, the sale of \$32,000,000 of 3 per cent bonds of the railroad company at 65. Information regarding that transaction could be found in the listing applications to the New York Stock Exchange which are published and in the hands of every broker; the Manual of Statistics for 1900 and 1901, Moody's Manual of 1901, the Commercial and Financial Chronicle; and in various circular letters, etc., issued by the company. The information was as public and as easily accessible as information of that character could possibly be.

You are so familiar with these transactions that it is unnecessary for me to attempt to restate in detail what they were. I shall therefore take up a few of the steps or incidents in these transactions which seem to me to have resulted in the most serious misunderstandings, and give you my views regarding them.

The first is the sale to the stockholders of the Chicago & Alton Railroad Company of \$32,000,000 of 3 per cent bonds at 65. You remember that very shortly after the syndicate acquired 97 per cent of the stock of the company the directors and stockholders authorized an issue of \$40,000,000 of 3 per cent bonds, and that of those bonds \$32,000,000 were sold to the stockholders pro rata at 65.

In the first place, I take it that all will agree that at that time in the history of the development of the Chicago & Alton Company's affairs some issue of new securities was necessary. The funded debt, carrying 6 and 7 per cent interest, was to mature in, I think, about two years, and had to be refunded. All agree that if the road was to keep its place among the important railroads of the Middle West, very substantial provision would have to be made for new improvements. Clearly

some issue of new securities was needed, and, I take it, no one will question the propriety of the action of the company in authorizing this issue of \$40,000,000 of bonds. So that the only question in this connection is as to the propriety of the sale of \$32,000,000 of these bonds to the stockholders at 65.

Let me point out first, what surprised me, I confess, that the sale of fifty-year 3 per cent bonds at 65 is raising money on a $4\frac{1}{2}$ per cent basis, the discount on the bonds being distributed throughout the period of the bonds. In other words, the practical result is the same as though the company had sold 5 per cent bonds at substantially par; and I doubt very much if anybody would have questioned the distribution of 5 per cent bonds at par among the stockholders, especially in the case of a corporation like the Chicago & Alton, which had such large earnings, and the value of whose property was so much in excess of the par value of its stock, even though the 5 per cent bonds thus distributed might have, in the hands of the stockholders, been worth 120 or even 130.

Bear in mind that it was the stockholders who received the benefit. That is the important fact, that this sale of 3 per cent bonds at 65 was made to the stockholders pro rata.

It is true that by reason of the low rates of interest which prevailed in 1900 and by reason of the fact that these bonds became savings bank investments in the State of New York when bonds of that character were very keenly in demand, about half of these bonds—to be accurate, \$17,000,000—were sold at surprisingly high prices, 90 or above, and an unexpectedly large profit was made on them. But that profit, whatever it was, was shared by the stockholders pro rata. In this connection it may be pointed out that about half of those bonds were finally distributed among the stockholders participating in the syndicate; and those who kept their bonds as investments, and have them to-day, have a very small profit.

MR. SEVERANCE. Is that in evidence?

Mr. CRAVATH. The record shows, as I remember it, that \$17,000,000 of those bonds—perhaps the amount does not appear—but that a substantial proportion were distributed. That appears in Mr. Kahn's testimony.

Mr. LOVETT. I think it was \$14,000,000.

Mr. CRAVATH. Yes. I think the bonds to-day, as a matter of common knowledge, are selling at about 78 or 79; that is, they have adjusted themselves to the change in the prevailing rates of interest. Instead of being upon a $3\frac{1}{2}$ per cent basis, as they were in those days, they are now upon a $4\frac{1}{2}$ per cent basis.

Now, again, let me ask you to test the propriety of the issue of these bonds at 65 by the standards which existed at the time they were issued. At that time, and for decades before, the issue of stocks and bonds to stockholders pro rata, at less than their market value was an exceedingly common and generally approved practice; and it is only within two or three years that the change of view regarding such transactions has taken place. Up to, I should say, three years ago, I for one never heard any criticism of a reasonable distribution of the stocks or bonds—the stocks being more frequent than bonds—among stockholders at a price substantially below the market value. That was the favorite or usual expedient for raising money among large railroad corporations in the past.

In Mr. McClement's report you will find many examples of such issues at approximately that time. For instance, in April, 1899, a few months before this Chicago & Alton issue, the Chicago, Burlington & Quincy Railroad Company, a conservatively managed company, issued to its stockholders over \$16,000,000 of $3\frac{1}{2}$ per cent bonds at 75, which immediately upon their issue sold above par, and I am informed that there was not a word of criticism of that transaction.

Go further back, to 1883, when Mr. Kellogg and Mr. Severance and I were boys in Minnesota. In that year the St. Paul, Minneapolis & Manitoba Railroad Company sold an issue of 6 per cent bonds at 10; dis-

tributed that issue among its stockholders at 10. It adopted that means of raising a moderate amount of money and of distributing a surplus among the stockholders. That transaction provoked no comment at that time. I think it would have provoked comment ten years ago. Those bonds, by the way, were 6 per cent bonds, and immediately after their issue sold above par.

The records are full of cases of this character, so that I think that there can be no doubt that in distributing these securities among stockholders at 65 the Chicago & Alton was pursuing a well-recognized and honorable method of raising money and distributing a benefit among its stockholders.

We have this additional justification, that the company had a large surplus, which I shall discuss later, a surplus of over \$14,000,000, and that, of the discount on those bonds, \$8,155,000 was charged against that surplus. That was not necessary. A corporation has the right undoubtedly to distribute the discount on bonds over the entire period of the bonds. That is clearly permissible and proper under the rules of accounting; but they chose to absorb \$8,155,000 of that discount by charging it against the surplus. And, let me say, there is no foundation for the suggestion that it was for the purpose of concealing the discount at which those bonds were sold. The fact that those bonds were sold at 65 to the stockholders was just as public, was just as well known, as a fact regarding the management of a big railroad corporation could be. Everybody knew it. It was published day after day in a great variety of forms, and it never would have occurred to anyone to conceal the fact. The purpose undoubtedly of charging \$8,155,000 of the discount against the surplus was that it was recognized that the issue of those bonds at 65, which was less than their market value, was an indirect distribution of surplus among the stockholders.

You will see from what I have already said that there was not the slightest danger of deceiving investors regarding the bonds. No investor who took the slightest pains to inform himself could have been ignorant of

the fact that those bonds were sold at 65 to the stockholders, any more than in dozens of cases with which you are familiar, investors have any doubt that the stock which they are buying on the market at 120, or 130, or 140, or 150 was distributed among the stockholders at par. Does anybody doubt, for instance, that any investor in Pennsylvania Railroad stock in 1903 knew perfectly well that when he paid 130 for the stock it was distributed among stockholders at a lower price? Those facts are bound to be known. They are widely circulated, and I venture to say that not a single investor in Chicago & Alton bonds was misinformed as to the price at which those bonds were sold to the stockholders.

Now we come to the next important event in this series of transactions, and that is the action of the Chicago & Alton—

Commissioner CLEMENTS. On that last point, whether it is lawful or unlawful, forbidden or not forbidden, is not the necessary result of that practice that the present owners of a property are enabled to take out a net surplus for their immediate distribution, and then in effect charge it up against the freight payers, at least so long as the feeling prevails that a road is entitled, if it can, to earn from its business enough to pay its fixed charges, the interest on these bonds in excess of anything that was paid for—aside from anything that is lawful or unlawful, is not that the outcome of that practice?

Mr. CRAVATH. To answer your question indirectly: I quite agree that there is ample basis for the view that the time will come when attention should be paid to seeing that the par value of securities outstanding bears a definite relation to the value of the property against which they are issued. I think there is no doubt about that. I also agree that so far as the existing situation is concerned, the *par* value of outstanding securities is not a safe guide as to the earning capacity or the intrinsic value of property. But it is true that the public have understood that, and it is remarkable to find how nearly the *market* value of securities corresponds to the real value and the *real* earning capacity

of the properties. In other words, the investor inquires at once, not what the *par* value of the stock is, but what the stock earns, and what relation it bears to the value of the property as shown by the corporation's reports.

Commissioner CLEMENTS. But when you look at it from the standpoint of the people who pay the freight, who patronize the road and pay the burdens of transportation—take, for instance, the case that you referred to a moment ago, where the distribution of the bonds was at 10 cents on the dollar, as I understood you to say, in some case some years ago, and when they were issued they soon became or immediately became worth par or more. That would net immediate distribution among themselves of 90 cents——

Mr. CRAVATH. Well, except——

Commissioner CLEMENTS. Equal to cash.

Mr. CRAVATH. In that case, it is fair to say, that was an indirect distribution of surplus. The theory of that distribution was that the corporation had a surplus, as I remember it; it had lines which had been paid for out of earnings, and adopted the means of creating those bonds to represent that additional value as well as the \$100 per bond paid in.

Mr. KELLOGG. What case are you speaking of?

Mr. CRAVATH. The Manitoba case in 1883.

Commissioner CLEMENTS. I only used that as an illustration of the point I was trying to present to you, and that is that when a transaction of this sort occurs and there is a distribution of bonds among stockholders for much less than they are worth or will bring at the time, it amounts to a net surplus at that time to them, but the property must make it good in earnings; and when you get into court on a receivership or anything of that kind, the interest on these bonds is a fixed charge, and may result in the bankruptcy of a road, or if not, in rates which would be very high on the basis of the actual investment.

Mr. CRAVATH. I think the test, Mr. Commissioner, is this: What is the fair earning capacity and value of the property? And, having determined that, I think

that the result, both to the public and to the State and to the stockholders, is the same, whether a small amount of securities carries a high rate of interest or dividend, or a larger amount carries a proportionately smaller rate of interest or dividend. Or, putting it differently, if a corporation distributes \$2,000,000 a year, it makes no difference whether that is distributed by a 10 per cent dividend on \$20,000,000 of stock or a 5 per cent dividend on \$40,000,000 of stock. But I quite agree that where securities do not bear some definite relation to the intrinsic value of the property, it becomes difficult in many cases to ascertain what the fair earning capacity is, and I shall not differ with you at all in advocating, under existing conditions, some regulation by law as to the amount of securities which should hereafter be issued against property and against earning capacity.

Now we come to the action of the Chicago & Alton Railway Company in readjusting its accounts and carrying to its surplus, \$12,444,000, which during previous years had been taken from earnings and expended for additions and permanent improvements, but in the first instance—that is, from year to year—charged upon the books of the company, not to capital, but to current expenditures.

I think that all connected with the company agree that these expenditures in the first instance could with entire propriety have been charged to capital account. The witness Hillard, the present comptroller of the company and the chief critic of these transactions in this investigation, said: "I have no doubt that they might have been fairly so charged, at the time." And here I will call attention to a circular not in the record, which had not been called to my attention at the time of the investigation, but which I have no doubt you will be glad to consider in connection with these questions now in issue, a circular issued by Mr. Blackstone in February, 1889, when he was opposing the sale of the stock to the Harriman syndicate. Mr. Mitchell, of Chicago, had made the offer on behalf of the syndicate to buy the stock at 175 for common and 200 for preferred, and Mr. Blackstone, the president of the com-

pany, who for years had been, as you doubtless know, the chief spirit in its affairs, while agreeing that the offer should be submitted to the stockholders, opposed the acceptance of it on the ground that the price was not high enough. He thought that the property was worth more; and in this circular, issued for the guidance of the stockholders, printed in full on page 7 of my brief, he said:

“In my communication addressed to you, under date of 31st of January, I made certain statements with reference to an offer made by Mr. J. J. Mitchell to purchase your shares. I now wish to supplement that statement by advising you that in case a majority of the shares of the company are not sold to the syndicate represented by Mr. Mitchell I shall advise that you authorize the refunding of the outstanding bonds of the company and the issue of a stock dividend to represent earnings heretofore invested in permanent improvements.”

So we have Mr. Blackstone on record, himself advocating that these expenditures which his own reports showed had been made for permanent improvements out of earnings should be carried to capital account, thereby correspondingly increasing the surplus, and that from that surplus a stock dividend should be declared to the stockholders.

Thus we have all these men agreeing that the expenditures were made out of earnings for permanent improvements, and we have Mr. Blackstone agreeing with Mr. Felton and with the present management that it was fair and proper to the stockholders that those expenditures should be carried as surplus and that the stockholders should have something to represent that investment.

Let me point out, too, what Mr. Blackstone said in another report in 1894—that the capitalization of the Chicago & Alton Company, including its bonds and all obligations assumed by it, aggregated less than 60 per cent “of the actual cost of the property in its present improved condition,” and that “a dividend”—I am quoting Mr. Blackstone’s own words—“a dividend of 8 per cent is, therefore, the equivalent of about $4\frac{3}{4}$ per cent upon

such a number of shares as would, together with the funded debt, represent the actual cost of the property."

There is another formal official declaration from Mr. Blackstone that the actual cost of the property exceeded by \$14,000,000 or \$15,000,000 the par value of the securities outstanding.

Commissioner HARLAN. Where were you reading from then, Mr. Cravath?

Mr. CRAVATH. At the top of page 6 of my brief. That extract from Mr. Blackstone's report is quoted in full in Mr. Felton's report which is in evidence—Mr. Felton's report on the strength of which the accounts were readjusted and these expenditures carried to surplus. I have just now read from the top of page 6 of my brief.

It is rather interesting to note here, gentlemen, that on Mr. Blackstone's own statement that the securities represented but 60 per cent of the cost of the property the intrinsic value of the stock was about 172. In other words, the syndicate paid just about what Mr. Blackstone estimated to be the intrinsic value of the property based on its actual cost, without any provision for accretions in value.

So I say that all managements agree upon the propriety, wisdom, and fairness of the readjustment of the surplus.

That readjustment is amply supported by accounting authorities. You will find in Appendix A to my brief an opinion by Price, Waterhouse & Co., Haskins & Sells, and J. H. McClement, three of the most distinguished authorities on railroad accounting that I could find, who all agree that it is entirely proper for a corporation after it has for years charged to current expense expenditures from earnings for permanent improvements which should at the time have been charged to capital, subsequently to readjust the accounts and carry those expenditures to capital account, thereby increasing the surplus. I will submit their original opinion. A copy is found in the Appendix to my brief.

The courts have also considered this question. I have avoided a multiplicity of decisions in my brief;

but I have cited at the bottom of page 7 a leading English case in which precisely this procedure was involved. A railroad company had for years been paying for certain locomotives and other rolling stock out of earnings and charging those expenditures to current expense. Finally its board of directors determined to do just what we did in the Chicago & Alton, to carry those expenditures to capital account, increase the surplus, and at once declare a dividend from that surplus. A stockholder made the same criticism that Mr. Hillard made, but the judge of the high court of appeals overruled the objection, and said:

“ I have no hesitation in saying that the circumstance that they had been paying what ought to be charged to capital out of revenue does not prevent their right or their duty to the persons who are looking for their payment out of revenue to credit back to revenue those things which have been carried for the time to capital account.”

So I say that the procedure we adopted was not only sound under the rules of accounting, but it is sound under the decisions of the courts.

We have now disposed of the readjustment of the accounts, and of the placing upon the books of this surplus increased by about \$12,400,000.

I think the next criticism of these transactions is as to the use of \$6,669,000 of the proceeds of the sale of \$32,000,000 of bonds for the purpose of paying a cash dividend of 30 per cent to the stockholders, that dividend being charged against the surplus which was created as I have just pointed out.

I have explained to you that the Blackstone management had announced its purpose of declaring a stock dividend, representing, I should say from the circular, the *entire* expenditure for improvements which had been charged to current expense. We differed from their procedure simply in declaring a *cash* dividend of 30 per cent which represented only about 40 per cent of our surplus. There can be no doubt about the legality of that procedure. There is not the slightest doubt, under the authorities, that where a corporation has a

surplus it may use the proceeds of bonds for the purpose of paying a dividend. On page 8 of my brief you will find a very brief statement of that rule from the fifth edition of Cook on Corporations, reading thus:

“When the company has used profits for improvements, it may lawfully borrow an equivalent sum of money for the purpose of a dividend. And it may properly borrow money to pay a dividend if, upon a fair estimate of its assets and liabilities, it has assets in excess of its liabilities and capital stock equal to the amount of the proposed dividend.”

As there can be no doubt about the *legality* of that dividend, I shall simply discuss its *propriety*.

You will remember that Mr. Blackstone had already committed himself to the policy of giving the stockholders something to represent this investment of earnings in the property, and that at the time the syndicate bought the stock at \$175 a share, according to our own books and according to Mr. Blackstone's own statement, every \$100 share of stock represented a little over \$170 in actual cash invested in the property. And that is without making any allowance for the great increase in the value of terminals and the value of real estate which must have taken place during the forty years since the company had begun business. So I can not see, I am bound to say, any reason in the world why under such circumstances the directors should not sell bonds when they could sell them, as they sold them then, on a $3\frac{1}{2}$ per cent basis, and take a moderate portion of the proceeds of those bonds and distribute it among the stockholders by way of an extra dividend, thus returning about 40 per cent of their profits which had during the previous years been invested in permanent improvements; that is, in building up the property. If they had a right to declare a *stock* dividend, they had a right to declare a *cash* dividend. I think that if it had not happened that when that dividend was declared the stock was represented by four men, it would to this day have provoked no comment. If there had been no change in the management, for instance, and the stock had remained in the hands of the seven or eight hundred holders who

originally held it, and it had been decided to distribute \$6,500,000 in cash from the proceeds of bonds sold on a $3\frac{1}{2}$ per cent basis among the stockholders, there would have been no criticism or comment. I think it was an entirely proper, as it was an entirely lawful, procedure, particularly under the standards which were then applied to such transactions as this.

Now we come to the final step, and that is the organization of the Chicago & Alton Railway Company, its issue of \$22,000,000 of $3\frac{1}{2}$ per cent bonds, and a little less than \$20,000,000 of preferred and \$20,000,000 of common stock in payment for the 97 per cent of the stock of the old railroad company which the syndicate owned, and for the line between Springfield and Peoria, for which the four leaders of the syndicate had paid \$3,000,000. There is not the slightest doubt that the purpose of that recapitalization was to give to the stockholders who had invested their \$39,000,000 in the railroad company's stock preferred securities which would represent approximately the then demonstrated value of that property, which they could sell and which were looked upon as investment securities, and common stock which they could keep and which would represent the control of the property and which would represent the future of the property—the value which, in their judgment, was there because of the probable increase in business, the probable increase of earnings and the probable increase of efficiency in management due to their control and to the growth of the country.

In this case and in other cases I think there is no doubt about the legality of the transaction. I think no one can question that the railroad company had the right to acquire the stock of the railroad company owning this short railroad, and the right to issue its own stock and bonds in payment therefor at a value fixed by its directors in good faith, considering all the circumstances, those of the past as well as those of the future. So again I shall confine myself to the discussion of the propriety of the transactions. I could cite authorities innumerable in Illinois which would

demonstrate beyond possible question the legality of the transaction.

Commissioner CLEMENTS. Mr. Cravath, when you add the 30 per cent dividend which was paid in money from the proceeds of these bonds and take into account the difference between 65, at which they were taken, and 90-odd, which they were soon worth, how much would that add to the profit in that deal in the bonds—the 30 per cent of cash dividend that was paid from the proceeds?

Mr. CRAVATH. It is interesting to note that the profit on this transaction was really very much less than supposed. Of course the profit to each particular individual depended upon when he sold his securities. If a member of this syndicate kept his bonds and kept all his securities, he to-day would have a very small profit, while he who sold at the most favorable time—and very few men succeed in selling at the most favorable time—would have made a substantial profit.

Commissioner CLEMENTS. The man who did sell at the best time and who sold, I believe it was stated here, to the New York Life Insurance Company—some of it at 90, I think—and only paid 65 for it and then got his 30 per cent dividend in cash, was able to get something like 60 per cent dividend all together, putting the two things together?

Mr. CRAVATH. No, Mr. Commissioner. You remember that was a sale of \$10,000,000 of bonds; it was not to the New York Life Insurance Company; it was to Goldman, Sachs & Co. The syndicate managers had no knowledge of and no dealings with the New York Life as the purchaser of those bonds. The sale was made to the banking house known as Goldman, Sachs & Co., and they in turn sold to the New York Life. That was only \$10,000,000 of the \$32,000,000 held by this syndicate. The average price secured for these bonds was very much lower. I believe that a man who sold at the most opportune time and took advantage of the highest prices would have made a profit in the proportion that \$6,000,000 bears to \$39,000,000—I think about 14 per cent.

Commissioner HARLAN. Was there not a market quotation of their bonds at 96?

Mr. CRAVATH. Yes; but the bonds were held by the syndicate, Mr. Commissioner, and were only marketed as the market took them. As a matter of fact, when the syndicate was dissolved, I think—in naming the precise amount I am speaking of the time when the syndicate was dissolved—only \$17,000,000 of bonds had been marketed, and the remaining \$15,000,000 were distributed pro rata among the one hundred members of the syndicate.

Commissioner CLEMENTS. To the extent that a stockholder in this syndicate paid only 65 and got 96, he was ahead something over 30 per cent, was he not?

Mr. CRAVATH. He was not ahead, Mr. Commissioner. He had reduced the cost of his stock.

Commissioner CLEMENTS. Fifty per cent. And when you add that to the cash dividend of 30 per cent—

Mr. CRAVATH. No particular stockholder sold at that price. The sale of the \$10,000,000 of bonds was made for the whole syndicate. It was shared pro rata by the one hundred members of the syndicate. But, answering your question, there is no doubt that to the extent of the 30 per cent dividend and to the extent of the profits which the syndicate did make on the bonds purchased at 65, they did reduce in effect their cash investment in the stock. There is no doubt about that; there is no doubt that that was one of the purposes.

Commissioner LANE. The sale of the 3 per cent bonds was not an isolated transaction.

Commissioner CLEMENTS. The point I was making was that the 30 per cent dividend was not the limit of the profits in this transaction.

Mr. CRAVATH. Oh, no; by no means. And I frankly say that the purpose of the recapitalization was to reduce the cash investment in these securities; and in the final step—that is, in the organization of the railway company and the issue of its securities—the purpose was undoubtedly to create preferred securities, the $3\frac{1}{2}$ per cent bonds and the 4 per cent stock, which were based upon the then value of the property and

which could then be sold, and to have common stock that would represent the future of the property and the added earning capacity which they thought would come in the near future. There is no doubt about that.

Commissioner CLARK. And the effect of it was to make these preferred securities cost them about 50 cents on the dollar.

Mr. CRAVATH. That I have not figured out; but I will state that in a different form in a minute, Mr. Commissioner. I will point out what relation those preferred securities had to the earning capacity of the property.

Commissioner CLARK. I only base that suggestion on the fact that they got a 30 per cent dividend in cash, which would reduce the cost to 70; and then, as you say, they netted about 14 or 15 per cent out of the bonds, which would bring it down to 55.

Mr. CRAVATH. The most fortunate man; very few men did that. The average profit was just about 14 per cent, I should say. You see we have a cost of \$39,000,000 for this stock. Roughly speaking, there was \$12,000,000 profit from the dividend and from the 3 per cent bonds. That would bring the \$39,000,000 down to \$27,000,000; so that the stock would still represent a cash investment of about \$27,000,000.

Commissioner CLARK. Less the profits on the bonds.

Mr. CRAVATH. No; after deducting it.

Commissioner CLARK. But there is \$12,000,000 absolute profit in the 30 per cent dividend.

Mr. CRAVATH. No; six millions and a half in the dividend; a maximum possible profit of about \$6,000,000 on the bonds. So, roughly, I say the \$39,000,000 was reduced by \$12,000,000 in the case of those stockholders who were most fortunate in selling their 3 per cent bonds at the maximum profit.

Mr. MILBURN. That is arguing on a hypothetical profit, which was never realized.

Mr. CRAVATH. Which was never fully realized.

Commissioner CLEMENTS. If they had a market value and were salable at that, the only reason a man did not

realize it was because he was waiting for something better, was it not?

MR. CRAVATH. No, Mr. Commissioner; they had a market value; but there was a limited market. The mere fact that the syndicate only disposed of \$17,000,000 would indicate that the remainder of their bonds could not be marketed at that price. You must remember that these bonds had a narrow market. They were savings banks' bonds. The ordinary man does not buy 3 per cent bonds, and these bonds could be sold at that price only to the extent that they could be purchased by institutions which wanted high-class bonds that were under the law savings banks' investments. The market was very narrow.

Now, what I want to say about the issue of these securities of the railway company is this: The gentlemen who were conducting this recapitalization were using the financial methods which at that time were generally in use, which were considered proper, and which were being applied to many railroads and to more industrials. The basis was, to issue preferred securities based upon the demonstrated earning capacity of the property, and common stock for the estimated additional value of the property, based on its future prospects. In Mr. McClement's report you will find a great many cases where just that theory of recapitalization was applied to important properties, and there was no criticism at the time. Then you must remember that this transaction at the time was fully understood. Just what was being done was known to thousands of people, and there was no adverse criticism. It was a transaction that was proper at the time under the standards which then prevailed and which were applied to such transactions.

If you will turn to page 12 of my brief, you will find how these rules were applied. First, the aggregate cash value of the property as of June 30, 1906, based upon the price paid for the old stock by the syndicate and including the expenditures for extensions and betterments was approximately \$77,000,000. In making this estimate, I take \$175 a share for common and \$200 a

share for preferred. That, however, happens to be almost precisely the intrinsic cost of the property according to Mr. Blackstone's own report. I then add to that the market value of the high interest-bearing securities about to mature, which had to be funded, and \$19,500,000 of additional capital expenditures made upon the property.

So, for the basis of our comparison, as of June 30, 1906, we have a cash value of about \$77,000,000. That is what the property cost in cash. No one can doubt the propriety of \$77,000,000 of securities being issued against that investment.

Now, what capitalization had we at the end of this recapitalization? That is my second figure. As a result of the recapitalization the total amount of securities (bonds at approximate market value and stocks at par) outstanding against that total cash value on June 30, 1906, was about \$105,000,000. Of course, where you create 3 per cent bonds and $3\frac{1}{2}$ per cent bonds they should be taken at their fair market value, not at their par value. The stocks, however, on any recapitalization should be taken at their par value, I agree. So our real capitalization of June 30, 1906, was \$105,000,000. In appendix C to my brief, page 23, you will find the details, beginning at the bottom of the page. We have \$37,350,000 of 3 per cent bonds, which I take at 90—ten points above their present market value, but I am assuming that at the time they could have been sold at the average price of 90—and \$22,000,000 of $3\frac{1}{2}$ per cent bonds at $82\frac{1}{2}$, much above their present market value, but their market value at the time when the low rates of interest prevailed. The notes are taken at their market value at the time; guaranteed stocks at 150, the same as in the earlier statement; and the common and preferred stock are taken at par.

So we have a capitalization of \$105,000,000 as compared with what I call a cash cost of \$77,000,000—an increase in capitalization of \$28,000,000.

The aggregate amount of preferred securities under the recapitalization—that is, both 3 per cent bonds and $3\frac{1}{2}$ per cent bonds taken at the assumed fair value,

which I have stated was much above their present value, and the stocks at par—was \$85,000,000, which is only \$8,000,000 in excess of the cash value. Now, remember that the tangible property of this company had increased enormously during the lapse of years. Its terminals had increased many times in value. Its large holdings of real estate had increased many times in value. But the amount of preferred securities outstanding exceeded the cost value by only \$8,000,000, or, if you deduct the cash dividend paid of \$6,000,000, by only \$14,000,000.

The real test, however, is the amount of earnings distributed. The average annual amount which the Chicago & Alton Railroad Company had been paying out in interest and dividends for many years prior to the recapitalization was \$2,906,000. That is the average amount actually paid, ignoring the profits carried to surplus or expended on permanent improvements. The annual fixed charge on June 30, 1906, including interest on all obligations and the 4 per cent dividends upon the preferred stock, was \$3,228,000, an increase of only \$321,000. But it must be remembered that in the meantime we had spent over \$19,000,000 in improving the property, and that this increase in fixed charges was only 1.43 per cent per annum upon this new capital and the \$3,000,000 paid for the Springfield-Peoria line. In other words, our preferred securities under the present plan, including the preferred stock, very little exceed the actual cost of the property, are less than its fair intrinsic value, making a proper allowance for the appreciation of values, and were based upon the average annual disbursements for dividends for upward of twenty years.

Commissioner CLEMENTS. That makes no allowance for future dividends on the stock?

Mr. CRAVATH. No.

We now come to the common stock. And in this connection let me remind you again that Mr. Blackstone had pointed out that, without any allowance for appreciation in values, the old securities outstanding represented only about 60 per cent of the aggre-

gate cash cost of the property. Therefore I take it that if we had confined our issue of securities to the amount of the preferred securities—to the \$85,000,000 of preferred securities—no one could say that we had made an excessive issue; because, based upon the earning record of the company for over twenty years, there would have been ample profits to pay every dollar of interest and every dollar of dividends. Or, putting it differently, there could be no serious criticism, under the standards which were being applied at the time. (You should remember I am discussing this transaction as of eight years ago.) If in place of the \$20,000,000 of stock, which for many years had carried 8 per cent dividends, we had created \$40,000,000 of stock carrying 4 per cent dividends, the result would have been the same. That is precisely the principle which was applied when the Great Northern and Northern Pacific acquired the Chicago, Burlington & Quincy stock, and for every \$100 of the stock thus acquired issued \$200 in new 4 per cent securities. The dividend charge was not being increased. The same rule was applied when the New York Central issued for every \$100 of Lake Shore stock, which was paying 7 per cent dividends, \$200 of New York Central bonds carrying $3\frac{1}{2}$ per cent interest. While the par value in each case of the securities outstanding was double, the fixed charge, the disbursements to the stockholders and the charge on the property were not being increased. And I do not think anybody, even at this time, would have criticised this plan, if the issue of securities had been limited to \$85,000,000. So I take it that the real criticism is directed against the \$20,000,000 of common stock which was issued to represent the future growth of the property.

Now, remember, up to our \$20,000,000 of common stock the past disbursements for dividends, based on the average for twenty years, was sufficient to pay the interest and dividends upon all of our securities.

I respectfully submit, again considering the standards which were being applied at that time, that the framers of this plan were entirely justified in their

judgment that the future of that property could be fairly valued at \$20,000,000 or even \$30,000,000. As a matter of fact, the increase was about \$28,000,000 over the actual cash cost of the property. In the first place, they had a right to consider the real increase in value which had taken place in the tangible property of the company. In the second place, they had a right to consider the probable growth of the country, the probable growth of the business, and their capacity, by applying modern methods of management and making liberal expenditures for the improvement of the property, to increase its net earnings.

In that connection I will call your attention to a report by a coordinate branch of the Government, the Department of Commerce and Labor, on the commercial valuation of railway operating property in the United States for 1904, in which they speak of the Chicago & Alton recapitalization. That report is made by Mr. Eaton, a well-known expert, and is adopted as a part of the report of the Department of Commerce and Labor. It is there stated that the average net income of the Chicago & Alton for the years 1901, 1902, and 1903 was \$3,356,790. The report continues:

“On a 4 per cent basis this would sustain a capitalization of \$83,917,250, or, on a 5 per cent basis, \$67,135,800. The price paid was \$39,773,425. It is safe to say that after making due allowance for rental of added mileage, the property is now worth \$20,000,000 to \$25,000,000 more than at the time purchased.”

This was the estimate made by an impartial observer six years after the purchase was made. He adds:

“It is entirely speculative to say what part of this is the normal growth during prosperous years and what part is the value the new owners brought by the greater energy and enterprise displayed and the relation with connections which they controlled. In view of the complete revision of operating methods which they brought about, our judgment leads us to credit the greater part of this increase to the new conditions which they created, joined, as they were, with the immense growth and prosperity of business.”

Here is the impartial estimate of a Government expert that the value of the property increased by from \$20,000,000 to \$25,000,000.

Let us analyze the earnings. The average annual net income of the company for eight years from 1891 to 1898, inclusive, which included four years of business depression, was \$3,082,000. That was the earning record which the framers of this plan had before them. To this amount should be added 5 per cent upon the additional cash invested, which turned out to be about \$22,500,000, which certainly they could assume would be the fair estimated additional income that would result from that additional investment. That gives \$1,125,000. We therefore have as an earning capacity, which may be fairly assumed from past achievements, of \$4,207,000. That amount would have been sufficient to enable the new Chicago & Alton Company under its recapitalization to pay all existing fixed charges and dividends at the rate of 4 per cent per annum on both preferred and common stock.

Let me make that plain. The average earnings of the previous eight years, increased by 5 per cent upon the expenditures for improvements, would have furnished an earning fund sufficient to pay all fixed charges under the recapitalization and 4 per cent on both preferred and common stocks.

In the case of most railroads in the West the net earnings since 1898 have increased in much greater proportion than have the gross earnings. If the Chicago & Alton Company had increased its net earnings in only the same proportion as the gross earnings increased, it would have resulted in the net earnings for the fiscal year 1906 amounting to \$4,900,000, which amount would have been sufficient to pay all fixed charges, rentals, 4 per cent dividends on the preferred stock, and leave a surplus of \$1,671,000, or over 8 per cent on the common stock.

I should point out that in 1905 for one year the actual earnings were sufficient to pay all fixed charges, 4 per cent on the preferred, and a shade over 4 per cent on the common.

The failure of the Chicago & Alton Company to meet the expectations of the framers of the plan and provide the expected dividends on the common stock is due chiefly to two causes. In the first place, instead of the property requiring \$6,000,000 of new money for improvements, as had been estimated originally, it has absorbed \$19,500,000 of capital for improvements. That is due to the great increase in costs, to a great development in the gross tonnage of the railroad, and, I have no doubt, also to some inaccuracy in the estimates at the time made.

The other cause, and a still more important cause, is the reduction in freight rates on the Chicago & Alton and in the territory through which the Chicago & Alton passes, a reduction which Mr. Harriman testified was about 30 per cent. You will find annexed to Mr. McClement's report a very interesting diagram showing the comparative growth of the gross income, net income, and of fixed charges. You will see that the fixed charges, including 4 per cent on the preferred stock—that is, the total disbursements to stockholders and bondholders—remained about stationary for the past twelve years; and that during the past six years the gross earnings have increased with startling rapidity, but the net earnings have remained almost stationary. They have increased in a slightly greater proportion than the disbursements for dividends and interest.

Here again is the reason why the Chicago & Alton Company to-day has difficulty in raising large sums of money for capital expenditures. There is no doubt that it has turned out that the recapitalization of the Chicago & Alton Company did not make sufficient provision for new capital. But the reason is that while the framers of this plan thought that \$6,000,000 was enough, they have been compelled to raise \$19,500,000. They thought they were making a very liberal provision for the future improvement of the property in providing a leeway of, I think, about \$12,000,000, which could have been raised with the reserved bonds.

If the freight rates of the Chicago & Alton Company had remained stationary, it would have earned 12 per cent on its common stock. I am saying all this simply

to point out to you that the framers of this plan were justified by the facts before them, and they have been justified by subsequent events in the sanity of their estimate that the company could, with good management and good business, earn fair returns on this \$20,000,000 of common stock.

Finally—and I am just about to close, gentlemen—I want to point out that the capitalization of the Chicago & Alton Railway Company is not excessive as compared with that of other railroad companies similarly situated. This is demonstrated by some comparisons which you will find on page 16 of my brief, and the basis for which you will find in Mr. McClement's report.

The present capitalization of the Chicago & Alton, including stocks and bonds, all taken at their par value (which is unfair to the Alton in comparison with other companies, because its bonds bear 3 and $3\frac{1}{2}$ per cent interest, while most bonds bear from 4 to 5 per cent interest), is \$114,000 per mile. Take seventeen other railroads, which have been selected by Mr. McClements, the average per mile is over \$150,000. If we take the fixed charges per mile, including dividends on preferred stock, in the case of the Chicago & Alton, we have \$3,328 per mile. In the case of twenty-four other railroads the fixed charges only—by fixed charges I mean interest on bonds—are \$4,997 per mile. The percentage of gross earnings—and this, after all, is the fairest test—the percentage of gross earnings required to pay fixed charges, as shown by the Interstate Commerce Commission report of 1905, in the case of the Chicago & Alton, is 19.57 per cent; of all other railroads of the United States, 18.63. The disbursements per mile required to pay fixed charges and dividends (4 per cent on Chicago & Alton common and preferred) would be \$4,515 per mile; in the case of thirty-five other railroads the amount is \$5,729 per mile.

I submit the following final conclusions:

First, these transactions were lawfully conducted. Second, they were conducted openly and all the essential facts were given wide publicity and have at all times been accessible to stockholders and to investors in

Chicago & Alton securities. Third, they were in accordance with the approved methods which at that time were in vogue in recapitalizing other railroad companies and large industrial enterprises. Fourth, they were conducted for the equal benefit of all stockholders and there was no discrimination or injustice as between stockholders.

Finally, while the Chicago & Alton transactions may be regarded as typical of a class of financial transactions which have been common in the past, and which have generally been regarded as proper, and whatever basis there may be now for objections to such transactions as a class, taking this as an illustration of a type of a large class of transactions, I submit there is no basis for singling out for special criticism the Chicago & Alton transactions and the gentlemen by whom they were conducted.

Commissioner HARLAN. Mr. Cravath, in what sense do you use the word "stockholders" in your fourth conclusion? Do you refer to the one hundred gentlemen who formed that syndicate?

Mr. CRAVATH. I refer to the one hundred gentlemen who formed that syndicate and the 3 per cent who did not sell to the syndicate.

Commissioner HARLAN. Does the record disclose who those one hundred members of the syndicate were?

Mr. CRAVATH. No, sir; but the record discloses that the syndicate consisted of about one hundred firms, individuals and corporations.

Commissioner HARLAN. Does the record disclose how many stockholders there were prior to this reorganization of the Chicago & Alton?

Mr. CRAVATH. No, Mr. Commissioner; but I have no doubt that there were several hundred.

Commissioner HARLAN. Seven or eight hundred, I thought you said a little while ago.

Mr. CRAVATH. There were several hundred, I should say.

Commissioner HARLAN. Then the stockholders you refer to in your fourth conclusion are all the remaining

stockholders of the Chicago & Alton and the gentlemen who undertook to reorganize it?

Mr. CRAVATH. Yes, sir.

Commissioner HARLAN. Of course, being in this process of reorganization, they would all get an equal benefit from it. So is it not a case where some one saw an opportunity to reorganize—some one that perhaps was not a stockholder at the time—and became a stockholder for that purpose?

Mr. CRAVATH. Undoubtedly, sir. The circular recommending the sales frankly stated that the men who were buying the stock thought they had the ability and capacity to increase the value of that stock. They were therefore willing to pay what was thought to be a high price for the stock, and they bought for the express purpose of—

Commissioner HARLAN. They simply bought an opportunity; was not that it?

Mr. CRAVATH. Undoubtedly.

Commissioner HARLAN. And to get that opportunity, they went into the market—and offered more than the stock had been quoted for during a year prior to the date of their offer. Is not that so?

Mr. CRAVATH. Yes; but less than what Mr. Blackstone thought to be the real value of the stock.

Commissioner HARLAN. But, taking the market value as a general test of the value of stock, they really bought an opportunity to reorganize and recapitalize this company?

Mr. CRAVATH. Yes; although the primary purpose was not to recapitalize, but was to apply modern methods of management, and thereby increase the value of the property. That was the basis of the operation, to increase the value of the property, and in connection with that they clearly had the plan to recapitalize.

Commissioner HARLAN. That might be so, if all the members of that syndicate retained the securities and retained the stock. But is this a fair statement of the facts: That here was an Illinois corporation organiza-

tion that was being run fairly well, with stockholders that were satisfied, and some one saw an opportunity to recapitalize it, and to take advantage of that opportunity went into the market and gave for the common and preferred stock much more than it had been quoted at on the market?

Mr. CRAVATH. Not much more; an advance of but a few points, as I remember it.

Commissioner HARLAN. The preferred was 200. Had the preferred been quoted at 200?

Mr. CRAVATH. My recollection is that the common had been selling at about 166 or 167.

Commissioner HARLAN. At any rate, they gave a substantial advance over the market quotations?

Mr. CRAVATH. Yes.

Commissioner HARLAN. Then they recapitalize and presently have an opportunity to sell \$40,000,000 of bonds at 90, which they acquired at 65. They also got a 30 per cent stock dividend. Now, if they then dispose of those securities and get out of the Chicago & Alton, is it not simply buying an opportunity to make money in a few months and letting the public subsequently get out of it as best they can?

Mr. CRAVATH. Well, I should differ with that statement. I should say they were not buying an opportunity to make a financial transaction merely. They were buying a property at a price at which the different owners were willing to sell it and in that way buying an opportunity of greatly increasing the value of that property and by that means making a profit on the purchase. Now, that, Mr. Commissioner, was the very principle that was being applied at that period in hundreds of situations. That was being commonly done. Properties were being bought at certain prices by men who had faith in the future, and in their own ability. They were being recapitalized by the application of precisely the same principles that were applied here. The preferred securities were sold on the market; the common stock was usually kept by the men who expected to work and create values. And I am bound to say that while the liberty which our laws allowed was

then abused, I think that in the main the country was an immense gainer from that liberality and that a very large part of our industrial advance in the past ten years is due to the creation of just such situations as this, providing an incentive to able and courageous men, having faith in the future, to develop the properties which they purchased and which they then sought to make more valuable.

Commissioner LANE. Mr. Cravath, would you mind following up your idea a little further? You have said, and the main portion of your argument is devoted to the proposition, that this thing has been done, but that the time has come for a change in method and that you recognize that there may properly be Federal regulation of capitalization. You represent Kuhn, Loeb & Co., the banking interests of New York, and the railroad interests. Would you mind stating in what form that regulation of capitalization should be?

Mr. MILBURN. That is up to you.

Mr. CRAVATH. That is a hard question, Mr. Commissioner. We have been very carefully considering in our State for some weeks past Governor Hughes's public utilities bill. The local traction interests which I represent believe in the principle of that bill, and I have been permitted publicly to express my views regarding it. One of the chief features of that bill is a very strong provision for the control of new issues of stocks and bonds of all public utility corporations, railroads, electric light companies, gas companies, and the like.

The provision which I have joined in recommending, as a modification of the provision originally drafted by the framers of the bill, is one which requires the consent of a public commission for every new issue of stocks or bonds by public-service corporations. I was very much opposed to certain provisions of the bill which forbade unconditionally the issue of stocks and bonds against franchises—for instance, which forbade an increase of capital on the consolidation of two or more corporations, and which forbade the issue of stock under certain specified conditions, because I knew perfectly well that there were scores of companies which would be

prevented from conducting lawful financial operations by reason of those restrictions.

Commissioner LANE. Do you mean to say you can put into the hands of this Commission, or any other body, the power to say that a certain issue of stock shall issue or not?

Mr. CRAVATH. I think the only way of working out a scheme of regulation is to give a proper body of public officials the right to exercise discretion and judgment with respect to new issues. It is impossible to formulate hard and fast rules which will fit the great variety of situations which must arise from time to time.

Commissioner LANE. Was it not decided in Minnesota the other day that a provision of that kind was unconstitutional as to the warehouse commission?

Mr. CRAVATH. I have not been able to get that decision yet. Our decisions in New York do not adopt the rule, as I understand it, as stated in that decision. Have you a copy of that opinion, Mr. Kellogg?

Mr. KELLOGG. I have one in town, at the hotel; yes.

Mr. CRAVATH. But our courts in New York, I think, have sustained, and would sustain, such a power in a public commission. I should very much regret it, if the law of the Minnesota decision, as it has been reported to me, should be accepted as general law. I think it would be exceedingly difficult for a legislature or for Congress to frame arbitrary standards to determine under what conditions stocks and bonds may be created and sold.

Commissioner LANE. Would it be better, in your judgment, to have the stock viséd by the Commission or by some authority in the first place, or to have power generally vested in the corporation to issue stock as it sees fit and have some power or authority to see that the money raised on the issue of such stock was expended as it was intended by the corporation it should be expended?

Mr. CRAVATH. I do not think that alone would accomplish your purpose, Mr. Commissioner. As a matter of fact, the history of corporations in recent years

furnishes very few cases of the misuse of the money when it once reaches the treasury of the company, and I think the purpose you have in view would not be accomplished unless there were some machinery whereby the public authorities could pass upon the amount of the securities to be created for a given purpose as well as the application of the proceeds from the sale of those securities.

Commissioner LANE. You think such a regulation as that would be beneficial to the railroad carriers of the United States, do you?

Mr. CRAVATH. I have come to the view—again, I should remark that it is no business of a lawyer making an argument to express his private views regarding questions of political economy—but I personally have come to the view that the gain from reasonable regulation of that character would be greater than the loss. There would be some loss, of course. It would be much more difficult to finance new enterprises requiring courage than under old conditions; but on the whole I think the gain would be quite out of proportion to the loss.

Commissioner HARLAN. Mr. Cravath, if you will return for a moment to the question I was putting, does this record disclose whether any members of the syndicate remained stockholders of the company after the reorganization of the company?

Mr. CRAVATH. I think it does not; no, sir.

Commissioner HARLAN. Then, for all the record shows, the syndicate took the road from the public at one capitalization, and subsequently, after a few months, left it in the hands of the public at a very largely increased capitalization, keeping for itself whatever profit there was in the transaction?

Mr. CRAVATH. No, Mr. Commissioner; the record shows that when the syndicate expired the securities were distributed; that no securities were marketed except the portion of the 3 per cent bonds; and that when the distribution took place among the hundred members of the syndicate, all of the $3\frac{1}{2}$ per cent bonds, all of the new common and preferred stock, and a portion—the

record does not show how much—of the 3 per cent bonds were then distributed pro rata among the members of the syndicate.

Mr. KELLOGG. I do not recollect any such testimony, Mr. Cravath.

Mr. CRAVATH. Mr. Kahn testified to that, as I remember it.

Commissioner HARLAN. The record does not disclose what became of the new stock, so far as the syndicate members were concerned?

Mr. CRAVATH. No; the record does not disclose what the members of the syndicate did with the new stock, but it does disclose what became of the securities on the expiration of the syndicate.

Mr. KELLOGG. Whatever there was left. Nobody said how much there was left.

Mr. CRAVATH. I will be very glad to say, for your information, what was the fact. We are not dealing now with a question on which there could be formal proof.

Commissioner HARLAN. So far as the record discloses, then, is it not true that the syndicate took this railroad from the hands of the public at a certain capitalization and after a few months left it in the hands of the public at a largely increased capitalization, keeping itself whatever profit there was in the transaction; and is not that the possibility of such a system?

Mr. CRAVATH. Of course, there is the inherent possibility in every such transaction of one set of owners selling their securities, undoubtedly; but I think this record does not justify the inference that this syndicate did sell their securities to the public. I know the fact to be that everything was distributed by the syndicate except about \$17,000,000 of the 3 per cent bonds, which the managers had sold. Then, of course, each member of the syndicate became free to do as he chose with his share of the securities, and what the hundred members of the syndicate did from that time on, no one knows; that is, no one man knows. Each man knows what he did himself. As Judge Lovett points out, the men who

were elected to the board of directors at the time of the formation of the syndicate still remain on the board and still control the company, subject to the changes which took place when the Rock Island bought a certain proportion of the stock on the market.

Commissioner CLEMENTS. Does not this case illustrate that so long as past methods are to be allowed, every well-managed road that is out of debt and not over-capitalized, possibly paying a good dividend and paying its debts, is a shining mark for transactions of this sort, by which the capitalization is to be run up by leaps and bounds, and the people of the future are to make good the fixed charges on a much greater capitalization than the property ought to carry?

Mr. CRAVATH. There is no doubt that this case illustrates that the liberty of action in the issue of new securities permitted by our laws, as they have heretofore existed, does make possible the creation of securities to a par value exceeding the demonstrated value of the property. Answering your question affirmatively, it does offer the opportunity to men of ability and courage to buy a property for a value which the public has placed upon it, based on its past achievements, and recapitalize it in the method which was applied here. I agree with you that under existing condition, with the country so fully developed as ours has been developed in the past fifteen years, with more business than we can do, the balance of advantage is distinctly in favor of very substantial restrictions on the issue of new securities.

Commissioner CLEMENTS. You think the rates ought to have——

Mr. CRAVATH. That is my own individual judgment. I am not speaking for my clients.

Commissioner CLEMENTS. You think the rates people are compelled to pay for transportation ought to have some relation to the actual investment in the property, do you not?

Mr. CRAVATH. Yes; and they do. I think in determining the reasonableness of a rate you must have

regard to the investment in the property; but I say this about the Chicago & Alton, Mr. Commissioner, that considering what this property cost, considering the risk which these men ran, considering that this property was started over forty years ago, the increase in the par value of the outstanding securities as compared with the actual cost is insignificant compared with the average increase in values throughout the entire country. The men who put their money into Chicago & Alton, if they had stood pat all through, and the existing stocks and bonds were worth par, and they had had dividends all the time, would not have fared nearly as well as the average man who invested in property of any kind thirty years ago.

Commissioner CLEMENTS. Do not practices of this sort also—the fact that they are not prohibited—afford facility for the combination of railroads, greater aggregations into greater systems?

Mr. CRAVATH. There is no doubt it has been the policy of our law, Mr. Commissioner.

Commissioner CLEMENTS. The suppression of competition and all that follows from combination?

Mr. CRAVATH. I do not think it has had so much the effect of suppressing competition as it has had the effect of building up big systems, and it has been the policy of our State legislation——

Commissioner CLEMENTS. I mean big systems composed of formerly competing lines. I do not mean simply the bringing of continuous lines into one system, but the bringing together of formerly competing roads into a noncompeting system, under a general management.

Mr. CRAVATH. Not speaking as a lawyer, but merely as an observer, my impression is that there has not been a serious combination of competing lines by exercising the privileges which these laws confer. Of course the laws encourage the creation of these great systems. The laws of almost every State in the West, and in the East, for that matter, encourage the acquisition by railroad corporations of the stock of

connecting lines, and in every conceivable way have encouraged the building up of these great systems which have been so useful in developing the country. There is no doubt about that.

Commissioner CLEMENTS. While they have encouraged the acquisition of connecting lines into continuous lines, most of them have statutes in condemnation of the acquisition of parallel and competing lines.

Mr. CRAVATH. Yes; it has been the policy of the State legislation to forbid the combination in any form of competing and parallel lines. It has been its policy to encourage the formation of great systems until within a very short time.

I thank you very much for your patience, gentlemen.

ARGUMENT OF R. S. LOVETT, ESQ.,

Representing the Union Pacific Railroad Company.

Mr. LOVETT. If the Commission please, on behalf of the railroad companies we represent, particularly the Union Pacific and the Southern Pacific systems, we wish to argue this matter before the Commission. We have attended the inquiry and hearings conducted by the Commission, and have endeavored to afford the Commission every facility in the power of these corporations for an examination of their relations and affairs. It has been manifest, I think, to everyone during the course of the inquiry that the real object of the investigation, so far as developed by questions propounded by counsel at the hearings of the Commission, was to ascertain whether there had been a violation of the anti-trust law or whether the relations of the Union Pacific and the Southern Pacific and their present methods of management are inconsistent with the anti-trust law.

Of course we will not undertake to follow in argument the range of the testimony. Obviously there were a multitude of facts developed which can not be very material now; and as we feel that the real question before the Commission, as far as those railways are concerned, is whether their relations are consistent with the

anti-trust law, I, at least, will confine my discussions largely to that question.

It is true, as I understand, that this Commission is not charged with the duty of enforcing that law, but it has collected the evidence bearing upon the relations of the two companies and their management, and the counsel who appear for the Commission have indicated that that is what they conceive to be the material issue before the Commission, and I take it you ultimately will make some report upon this matter. We feel deeply that there is nothing illegal in the ownership of the stock of the Southern Pacific by the Union Pacific, nothing illegal in their relations, and as we have not attempted to develop our position with reference to that heretofore we think it is only fair to the Commission and fair to the stockholders of these companies that our view of the legal aspect of this question should be presented.

Of course we have here no complaint and no issue joined, and we are almost forced to make our own selection of the topics for discussion.

I shall have but very little to say about the Chicago & Alton matter, because Mr. Cravath has presented that so fully, but I have tabulated some figures appearing from the evidence in the record that I think bear upon some points that have been suggested in the discussion between Mr. Cravath and the members of the Commission that I shall present, and I shall do that before I pass to the discussion of the question in respect to the relations of the Union Pacific and the Southern Pacific.

All the criticism aroused by republishing the facts fully published seven years ago in reference to the Chicago & Alton seems to have been visited upon Mr. Harriman. He has not attempted to shirk any of the responsibility, but I think has been overgenerous in assuming it. He was but one of four, as shown by all the records introduced; but the four, namely, Messrs. Harriman, Gould, Schiff, and Stillman, who appear of record as the owners of 97 per cent of the stock, were merely the representatives of a syndicate of more than one hundred individuals and firms, and consequently

got but a comparatively small share of whatever profit was realized instead of all, as seems to be assumed.

I take it that the value of the Chicago & Alton, as the value of any other property, depended upon its assets and its earning capacity, and according to both of those standards the property at the time of this purchase was worth approximately \$59,000,000. Mr. Blackstone, the former president of the company, in his report to the stockholders for the year 1894, as Mr. Cravath has pointed out, called attention to the fact that the capitalization of the company was less than 60 per cent of the actual investment in the property. In his report for the year 1898, which was the last report he made to the stockholders, he spoke of the dividends that the company had paid. I will read a paragraph from that report:

“Much comment has recently been published in the newspapers relative to the reduction of dividends by your company from 8 per cent to $7\frac{1}{4}$ per cent in 1897 and 7 per cent in 1898. An unfavorable deduction as to the value of your road appears to have been drawn therefrom. I trust I may for that reason be pardoned for reading certain statements heretofore made which show, among other things, that a reduction of the dividends is not without a precedent in the history of your company. The dividends paid in cash upon the common stock of your company during the last thirty-five years are equal to an average of 8.36 per cent per annum. The average dividends for the last eighteen years, including $7\frac{1}{4}$ per cent paid in 1897 and 7 per cent in 1898, is a fraction more than 8 per cent per annum.”

That is evidence of the value of the property of the company and of its stock as shown by the rate of dividends that had been maintained through a series of thirty-five years.

Then, as to the value of the property in excess of the par value of the capital obligations of the company, he made the statement in the annual report for 1894, which has been read by Mr. Cravath and which I need not repeat.

Now, in respect to the latter statement—that is to say, the statement to the effect that the capitalization

was less than 60 per cent of the value of the property, I have had some figures made. Taking 60 per cent—although less than 60 per cent is mentioned—on the \$35,492,000 outstanding obligations at the time the syndicate bought the stock, would bring the actual cost of the property in 1894 up to \$59,153,000. That is to say, that the amounts originally paid in on the stock, actually expended upon the property by the holders of the stock and received as the proceeds of bonds sold and put into the property and the amounts over and above the ordinary expenditures for maintenance which had been expended for betterments and additions, made the actual investment in the property upward of \$59,000,000, or \$24,000,000 in excess of the capital obligation.

Then followed Mr. Blackstone's circular, in February, 1899, advising the stockholders against the acceptance of the offer made openly of \$200 for the preferred and \$175 for the common stock, and promising that in the event they should not sell he would recommend the declaration of a stock dividend.

At the time of this purchase—to digress a moment from the figures I have here—at the time this syndicate purchased the stock, in January, 1899, the surplus of the company, as shown by its books, was a little upward of \$2,000,000. The Commission is familiar with the report, made after the syndicate purchase, by President Felton, that he had found, charged against income capital expenditures exceeding \$12,000,000, and the board ordered the accounts restated, so as to add that to the capital account. That made a surplus of about \$14,000,000—a little upward of \$14,000,000. Six million six hundred thousand dollars of that surplus was distributed by a cash dividend. That left about \$8,000,000 surplus, and the discount on the bonds to the extent of \$8,000,000 was charged against that surplus; in other words, the cash dividend and the discount on the bonds disposed of the surplus, as I understand the record; the reason why that particular amount of \$8,000,000 was charged against the surplus, as I understand, was that it eliminated the surplus—absorbed the surplus.

Commissioner CLEMENTS. What do you mean by discount on the bonds?

Mr. LOVETT. I mean the difference between 65 per cent, the price at which they were sold, and the par value. That amounted, as I recall the figures, to about \$11,000,000.

Mr. CRAVATH. The larger proportion of it was charged to surplus.

Mr. LOVETT. Yes; and the balance of the surplus was absorbed in that way.

Observe here that you can not treat the cash dividend of 30 per cent and the sale of the bonds at 65 as isolated transactions. You can not separate them from the general transactions of the syndicate, the general result to those who participated in the syndicate.

The operations of the syndicate resulted in this: For \$3,479,500 of the preferred stock of the old company, at 200, the amount they paid, was \$6,959,000. For \$18,751,500 of common stock, at 175, they paid \$32,814,425. That made an investment in the stocks of the old company by the syndicate of \$39,773,425. Now, \$32,000,000 of 3 per cent bonds, at 65, cost the syndicate \$20,800,000.

The Peoria & Springfield line cost \$3,000,000. In this table I have before me there is added \$500,000 for expenses, commissions paid Mitchell and others for buying the stock, counsel fees, and the various expenses that attend an enterprise of that sort.

That brings the total investment of the syndicate up to \$64,073,425. Now, they received back very soon afterwards, I believe it was in May, 1900, \$6,669,180 by way of the 30 per cent cash dividend. That brought the outlay of the syndicate down from \$64,000,000 to \$57,404,245. That was the money that the participants in this syndicate had to raise. Each according to his own share contributed money which, in the aggregate, amounted to \$57,404,000.

Now, for that—eliminating the details of the method of procedure—for that what did the syndicate get? What did they have to show for this \$57,000,000 cash?

They had \$32,000,000 of Chicago & Alton 3 per cent bonds.

I will state here, by way of parenthesis, that the remainder of the issue of 3 per cent bonds was sold afterwards from time to time by the company at 83 and 83½, and along there. They were not in the syndicate transaction. They were the reserve securities that were issued from time to time for improvements.

Mr. MILBURN. They brought 83 and 83½?

Mr. LOVETT. Eighty-three to 83¼. They were sold in lots from time to time.

Mr. SEVERANCE. Were they not collateral?

Mr. KELLOGG. The testimony shows the remainder of them were up for collateral, \$7,000,000 of them.

Mr. LOVETT. The testimony of your man Hillard shows \$5,000,000 sold.

Mr. KELLOGG. I do not see it.

Mr. SEVERANCE. I think you will find that \$5,000,000 is the sum of money for which \$7,000,000 of the bonds were pledged as collateral.

Mr. CRAVATH. There are \$37,350,000 outstanding.

Mr. LOVETT. Of those bonds outstanding.

Mr. KELLOGG. Where do you get that?

Mr. LOVETT. From page 179 of the print of the exhibits I have, Hillard Exhibit No. 1. After showing the disposition of the \$32,000,000 of bonds it says:

“Additional bonds under this mortgage were issued as follows:

“‘September 7, 1904, for acquiring the railroad formerly belonging to the Quincy, Carrolton & St. Louis, \$350,000.’”

Mr. KELLOGG. Those were in addition to the \$40,000,000, no part of the \$8,000,000.

Mr. LOVETT. The mortgage provides for an issue of \$40,000,000 and an additional issue afterwards of \$5,000,000, I believe, for improvements. I am speaking of the total issue of 3 per cent bonds under the mortgage. They are exactly in the same rank, the same class, and a part of the same issue.

Mr. KELLOGG. Certainly.

Mr. LOVETT. I do not care which particular provision of the mortgage they were issued under. They were bonds issued under and secured by this mortgage and were exactly on the same footing as the other.

March 31, 1905, they issued, in accordance with subdivision 3, article 3, refunding mortgage bonds for betterments, sold at $83\frac{1}{2}$, \$2,000,000. July 31, 1905, they issued, in accordance with subdivision 3, article 3, sold at $83\frac{3}{4}$, \$3,000,000. That makes \$5,350,000 that were sold.

Now, some of the bonds are up as collateral—have never been actually sold. There is a total issue provided for in the mortgage, I believe, of \$45,000,000, but the syndicate bonds, the bonds that the syndicate took under this subscription at 65, aggregated \$32,000,000, and that is the issue I am dealing with.

Now, to return. The syndicate received for the investment of \$57,404,245, made in the way I have indicated, \$32,000,000 of the 3 per cent bonds, \$22,000,000 of the $3\frac{1}{2}$ per cent bonds, \$20,000,000 of the preferred stock, and \$20,000,000 of the common stock.

I believe it was stipulated in New York that the Financial Chronicle might be referred to as if in evidence, and I have tabulated here from the Financial Chronicle the high and low prices for all of these securities on the New York Stock Exchange since they were listed in October, 1900, down to date and have furnished counsel a copy. That shows that these 3 per cent bonds never, after they were listed, sold as high as 96.

I will leave this with the Commission. It gives the high and low price each month for the 3 per cent bonds, the $3\frac{1}{2}$ per cent bonds, the preferred stock, and the common stock. I think it will be apparent to anyone who examines the list that the average during this period—from the time the new securities were listed in October, 1900, to date—will not be over 82 or 83 per cent for the 3 per cent bonds; that the average for the $3\frac{1}{2}$ per cent bonds will not be far from 75, and that the average for the preferred stock will be around 75.

(The paper referred to is as follows:)

CHICAGO & ALTON RAILWAY COMPANY.

Prices on New York Stock Exchange from October, 1900, to March, 1907.

Year and month.	Common stock.		Preferred stock.		Year and month.	Common stock.		Preferred stock.	
	High.	Low.	High.	Low.		High.	Low.	High.	Low.
1900.					1904.				
October.....	36½	31	72½	69	January.....	38½	33	85½	75
November....	41½	33	77½	68½	February....	40	34	85	81½
December....	42	37½	78½	74½	March.....	40	35½	83	80
1901.					April.....	38½	37½	82	80½
January.....	41½	36½	76½	72½	May.....	38½	35½	81½	80½
February....	40½	38½	75½	74	June.....	38½	35½	81	80½
March.....	43½	38½	78	74½	July.....	41½	38½	81	80
April.....	50½	41½	82½	76	August.....	42	39½	83	82
May.....	49½	27	82	72½	September..	42	39½	84½	80
June.....	49	43	82	78	October.....	40	36½	80	80
July.....	45½	34½	79½	74½	November....	47½	37½	85	83
August.....	41½	36	78½	75½	December....	45	38½	85	82½
September...	40½	36	79½	76½	1905.				
October.....	38	36	78½	76½	January.....	43½	40½	83½	80
November....	38½	35½	78½	76½	February....	43½	41½	82½	82
December....	36½	32	78	75½	March.....	44½	38½	83½	80
1902.					April.....	42½	32½	83½	80
January.....	36½	33½	77½	76	May.....	35½	31	79½	77½
February....	37½	33½	77½	75½	June.....	36	35	81½	77½
March.....	36½	35½	76½	75	July.....	37½	35	81	78½
April.....	39½	35½	77½	75½	August.....	42½	35½	81½	80½
May.....	39½	35½	77½	75½	September..	36½	35½		
June.....	39	36½	77½	74½	October.....	36½	34	79½	75
July.....	45½	37	79	74½	November....	34	32½	77½	76
August.....	44½	41½	77½	77½	December....	33	30	76	75½
September...	43½	34½	76½	73	1906.				
October.....	38½	33½	75	71½	January.....	38	30	80½	74½
November....	36½	30	73½	68	February....	32½	30	79½	79
December....	34½	29½	72	69½	March.....	31½	31½	78½	78½
1903.					April.....	35	30½	76½	74½
January.....	37½	34½	73½	71	May.....	30	25	77	74
February....	36½	33½	72	71½	June.....	30½	30	78½	76½
March.....	34½	30½	71½	68	July.....				
April.....	32½	28	70½	67½	August.....				
May.....	31½	27½	70½	67½	September..	32½	25½	75½	75½
June.....	28½	25	68½	66½	October.....	35½	29	77½	75½
July.....	26½	19½	67½	64½	November....	32½	29½	76½	75
August.....	24½	19	65½	61	December....	31½	26½	75	70
September...	23½	18½	64	60	1907.				
October.....	28½	20½	65½	60	January.....	27½	24½	69	65½
November....	33	27½	70½	64	February....	22½	18	65½	65
December....	36	32½	75½	68½	March.....	20	14½	61½	59

CHICAGO & ALTON RAILWAY COMPANY.

Prices on New York Stock Exchange from October, 1900, to March, 1907.

Year and Month.	3½ per cent bonds.		Refunding 3 per cent bonds.		Year and month.	3½ per cent bonds.		Refunding 3 per cent bonds.	
	High.	Low.	High.	Low.		High.	Low.	High.	Low.
1900.					1904.				
October	84	81½			January	77	74½	83	81½
November	85½	82½	93	92½	February	76½	75	84	82
December	86	84½	93	93	March	77½	75	84½	83½
1901.					April	77½	76	83½	82½
January	85	83½	94	93	May	80	77½	83½	83
February	86	84½	92½	92½	June	79½	78½	85	82½
March	85½	84½	93½	93½	July	79	78½	85½	84
April	86½	84½	90	90	August	79½	78	84	84
May	86	84½	91½	91½	September	80½	79	85	84½
June	87½	86	92½	92½	October	81½	80	83½	83
July	85½	84	90	90	November	82½	80½	85	83
August	85	84	89	88	December	82½	82	85	83
September	85	84	88	87½	1905.				
October	85½	84½	88	86	January	83	80½	85	84½
November	86½	84½	87½	87	February	82½	82	85½	85
December	86½	85½	88	87½	March	82½	81½	86½	86
1902.					April	82½	81½	85	84½
January	84½	84½	88	87½	May	82½	80½	85½	84½
February	84½	84	88	87½	June	82	80½	85½	84½
March	84½	84	87½	87½	July	80½	79½	86	84½
April	84½	84½	86	85	August	83½	80	85	84½
May	85	84	86	85	September	83½	82½	85	84½
June	86	85	85½	85	October	82½	81	83½	82½
July	83½	83	86	85	November	81½	80½	83½	82½
August	83½	81½	85	84½	December	80½	79½	83½	82½
September	82½	81	85½	84½	1906.				
October	81½	79	83½	82½	January	81½	78½	82½	82½
November	81	78½	82½	82½	February	82	80½	82½	81½
December	81	78	83½	82½	March	80½	80	82	81
1903.					April	80½	80½	80½	80
January	79½	78	83½	82½	May	79½	78	80½	80
February	78½	77	83½	83½	June	80½	78½	80½	79
March	77½	75	83	82	July	78	76½	81	80½
April	77	74	82½	80	August	77½	76½	80½	80
May	77½	76	82	81½	September	77½	77	80½	80½
June	76½	75½	81½	81	October	80½	78½	83	78½
July	74½	71	81	80½	November	78½	77	80½	80½
August	73½	70½	81½	80½	December	78	76½	79½	79½
September	73½	72½	81½	81	1907.				
October	75	71½	83	79½	January	76½	73½	80	79
November	74½	72½	82½	81½	February	74½	72½	80	78½
December	76½	73	82	81	March	72	67½	78½	76

Mr. LOVETT. Now, the question here is not the rate at which the 3 per cent bonds were subscribed, but what the syndicate could realize from these securities, how they could get back the \$57,000,000 which they unquestionably invested, and which was represented by these securities. If the 3 per cent bonds had been sold at 80, which is about the average price during the past six years, in order to get back the money it had invested the syndicate would have to sell the preferred stock at 77 and the $3\frac{1}{2}$ per cent bonds at 75. At these prices the securities would have produced a few dollars more than the \$57,000,000 they had invested.

So that really you may vary those figures as you choose. If you raise the price of the 3 per cent bonds, you must pull down the price of the other securities. That is what those securities represented.

Commissioner LANE. I do not see that. Why do you have to bring down the price of the other securities?

Mr. LOVETT. Well, I am not sure that I see that myself, as I recall the statement.

Mr. SEVERANCE. To get the same total, you mean?

Mr. LOVETT. They had this amount of securities and if they got more than 80 for the 3 per cent bonds, of course the difference between the figures that I have named here and whatever they got for the bonds would be profit. If they got more than 75 for the $3\frac{1}{2}$ per cent bonds the difference between 75 and what they sold for would represent profit, and so if they got more than 77 per cent for the preferred stock, the difference between that figure and what they sold for would represent profit. These prices are assumed as indicating what these securities cost the syndicate.

In order to get back their money—\$57,404,245—they would have to realize these prices or prices averaging this rate. In other words, if you count the 3 per cent bonds at 65, it does not represent the cost to these people of their participation in the syndicate. You must raise very much the price of the preferred stock and the $3\frac{1}{2}$ per cent bonds in order to make up the \$57,404,245 that it was necessary for them to realize in order to get back the money they had invested.

Commissioner CLARK. To sum it all up, they paid \$57,000,000 for that property, they reorganized it, and they issued \$94,000,000 par value of securities?

Mr. LOVETT. Yes, sir; they issued \$94,000,000 of par value for what cost them \$57,000,000. That is a clear and graphic way of stating it. Now, what they got for it depended, of course, not upon the par value of the securities, but upon what they succeeded in selling those securities for.

Commissioner CLARK. It would depend altogether upon when and how they sold them?

Mr. LOVETT. Yes; and of course what they would get for them would depend on how and when they sold them, and the table here shows the prevailing prices from that period down to date upon the New York Stock Exchange.

I think it is fair to say, from that table, that they probably did not average over 25 for the common stock if they sold it. That was clear profit. Twenty million dollars in round numbers of the common stock at 25 would be \$5,000,000 of profit, and I think that is a good price to assume that they received for that amount of stock. Then whatever they got for these 3 per cent bonds, if the participants sold them, or whatever they got in excess of these prices I have assumed here—80 for the 3 per cent bonds, 75 for the 3½ per cent bonds, and 77 for the preferred stock—would be profit; but I submit if you compare these figures with the prevailing prices you will see that the profits on those issues could not have been very large, and we must realize we are dealing here with an investment of \$57,000,000 of cash.

Commissioner LANE. According to your figures and estimates, it does not mean much more than \$60,000,000, taking the averages you have given on the bonds and the averages on the stocks. Figuring the common stock in at 25, it does not leave much more than \$60,000,000 in return for their \$57,000,000 investment.

Mr. LOVETT. It would leave them, according to my figures, \$62,000,000 for an investment of \$57,000,000. That is to say, these prices that I have named produced \$57,000,000, which was the amount of their in-

vestment, and then the common stock, at 25, would produce \$5,000,000 more, and whatever profit they made out of it was made out of the common stock, and any prices in excess of those I have named in this statement. I have no doubt that if they sold these bonds they did sell for something above 80. How much I do not know. The record does not show and nobody knows, of course, unless you get everybody and ask each one what he sold for. But the highest quotation of the 3 per cent bonds during the year 1906, that has just closed, and down to date this year was 82½. The highest quotation for the 3 per cent bonds in 1905 was 86. The highest for the year 1904 was 85. I am giving you the highest quotation on the New York Stock Exchange for the bonds during that period. It was an experiment in issuing 3 per cent securities, and when first issued seem to have sold higher than they have ever sold since.

Commissioner CLEMENTS. If the plan presented in the case involved only the rights and interests of the syndicate and the old stockholders and corporation, the stockholders among themselves, that is one thing, but the effect upon the public is another.

Mr. LOVETT. Yes; I shall be very glad, Mr. Commissioner, to discuss that feature of it. I am not here as an advocate of the issuance of fictitious securities or of securities in excess of the real investment. I have some views upon that subject. They are not matured. I am not a statesman, but simply a lawyer, and I deal with the legal aspects of the situation only.

I do not understand that the par value of stocks and bonds is anything more than one circumstance out of a great many to be taken into account by any public tribunal charged with the duty of fixing rates. The Supreme Court of the United States, in the Nebraska rate case, specified a number of circumstances which might be taken into account. It did not undertake to say the particular value that should be attached to one circumstance as against another, but the par value of securities is a mere circumstance to be taken into account.

The Supreme Court of the United States many years ago held in the case of *Dow v. Bedelman*, 125 U. S.,

that the amount of stocks and bonds was not even prima facie evidence, did not make out a prima facie case in a suit attacking a system of rates established by a State tribunal.

I think it is a circumstance, as the court in the Nebraska rate case has said, that ought to be taken into account, but I do not think that anybody charged with the duty of making rates would attach very much importance to that circumstance alone. The natural inquiry would be, What do the stocks and bonds represent? What are they worth? And you fall back on the question as to the value of the property; that is inevitable in every controversy of that sort.

My own view is that entirely too much importance has been attached in the public mind and in legislation, and in public discussions generally, to the par value of stocks. I think it ought to be treated as wholly without legal significance. We all know, of course, that a share of stock is simply an evidence or a specification of the particular interest that each individual has in the net assets of the corporation. That is all it amounts to. We know that one share of stock which bears upon its face a certificate that it is a share of \$100 will sell for \$10 and we know that another certificate with precisely the same recital will sell for \$500. So, as a matter of fact, in everyday practice in the business world the par value of stock is absolutely without any significance.

Suppose that in this case instead of issuing 400,000 shares of stock, as they did, at an assumed value—an arbitrary specified value—of \$40,000,000 the organizers of this company had declared that the stock of this company should consist of 400,000 shares—had said not a word about the par value—of which 200,000 shares should be preferred stock and 200,000 shares should be common stock, and that the preferred stock should receive dividends at the rate of \$4 per share—not 4 per cent, but \$4 per share—before any dividends should be paid on the common stock; not one word about the capital or the amount of it, but simply a division of the shares. I do not pretend to be familiar with the

particular process that may be prescribed by the laws of Illinois, where this company was formed, but in the absence of some arbitrary statutory requirement, we all know—we lawyers, at least—that that would have accomplished the legal purpose as well, and would have been just as lawful as the method that they did pursue, of dividing it arbitrarily, saying this common stock represents \$100 a share.

What would have been the result? The 200,000 shares of preferred stock would have been selling on the market at \$70, or \$75, or \$80 per share, or whatever the price might be, and the common stock would have been selling at \$15, or \$25, or \$30, or \$40 per share, whatever the market price happened to be. The legal result of the transaction would have been precisely the same as it is to-day. The value of the stock would have been exactly the same as it is now if no par value were stated in the certificates for the shares. If that course had been followed, there would not have been any question of watered stock or of fictitious values and yet legally the situation would have been precisely the same as it is to-day.

For that reason I say that the importance of the par value of the stock is exaggerated, and, as I view it, in the making of rates it is a circumstance and, standing alone, is a trifling circumstance.

Commissioner CLEMENTS. Are you speaking of stock alone now?

Mr. LOVETT. I am speaking of stock alone. It stands on a different footing.

Commissioner CLARK. And not of bonds?

Mr. LOVETT. When we come to a bond, that is a form of debt. I do not care whether it is a bond or a promissory note or what it is, it represents money. It carries with it a fixed obligation to repay it at some time. Of course, in a bond there is a promise to pay, and it is necessary in that case that there should be a par value, because the corporation undertakes to pay a fixed sum. The stockholders collectively, through this fictitious person, undertake to repay on a certain day a fixed sum of money. That, of course, is necessary; but so far as

stock is concerned, it seems to me, all the discussion about watered stock and fictitious capital is unimportant as a practical matter.

Commissioner CLEMENTS. It is quite a common thing, when cases arise before the Commission where the rate of a railroad is challenged as being unreasonable, for the defense to show that their gross receipts are so much, their expenses so much, their fixed charges, including interest on bonds and other things, so much, and that the surplus is gone, and there is nothing for the stockholders, and therefore there can not be an unreasonable rate while that condition can be shown by the road. I suppose the stockholder's share represents some investment, and if it does, then it is entitled to participate in earnings as a return for that investment. Would it not become important to know what it is, whether it is a mere figure written on a paper, or whether it is so many dollars and cents?

Mr. LOVETT. I agree fully with the proposition that in any rate hearing—any rate controversy—where the proposition is to reduce rates, the value of the property is an important element. I do not say for a moment that they are limited to the return on the original investment, but I do say that on the question of confiscation the value of the property is a prime consideration.

I have had to do, in my limited practice, with a number of rate suits, and I know of no case except in the case of *Dow v. Bedelman*, in which the lawyers representing the railroads felt safe in standing on proof of the amount of securities outstanding, but always went behind the record and proved the money invested in the property, and it is frequently a very onerous undertaking to attempt to show in the case of some of these old roads just what has been invested.

Commissioner CLEMENTS. Judge Lovett, we will take a recess now until 2 o'clock.

The Commission, at 12.35 o'clock p. m., took a recess until 2 o'clock p. m.

AFTER RECESS.

The Commission reassembled at the expiration of the recess.

Commissioner CLEMENTS. Judge Lovett, you may proceed.

ARGUMENT OF R. S. LOVETT RESUMED.

Mr. LOVETT. If the Commission please, I have but little more to say about the Chicago & Alton.

Continuing the point that I was discussing when the recess was taken, in response to a question suggested by one of the Commissioners, I take it that really the best evidence of, the safest guide to the value of railroad property, or any other property, is the market value of its securities, where they are largely dealt in, on the market. I think that is probably the best evidence of it. Of course, even that depends to a considerable extent upon the rate of interest the bonds bear and the dividends the stock pay.

Commissioner CLEMENTS. And in turn that would depend upon the rates they are permitted to charge and can get?

Mr. LOVETT. Yes. The Supreme Court in the Nebraska case has left that revolving in a circle; but there must be some way of arriving at the value of railroad property. It is to be gathered from a great variety of circumstances, and while there are many circumstances to be considered, it seems to me that ordinarily and as a general rule, that the market quotations for securities during a long period of time is probably about the safest guide.

But the important fact, which seems to be persistently disregarded in the discussion of the Chicago & Alton, is the return in the way of interest or dividends upon the capitalization of the property before and after the readjustment. The old bonded indebtedness was bearing interest at the rate of 8 per cent and the new at 3 per cent and $3\frac{1}{2}$ per cent.

At the close of the fiscal year June 30, 1906, it was, roundly speaking, six years since the readjustment of the finances of the Chicago & Alton occurred. The re-

sults of the readjustment, therefore, will more clearly appear by a comparison of the annual interest and dividends for the year ending June 30, 1906, with the average payments for interest and dividends for the six years immediately preceding the readjustment—that is, the calendar years 1894 to 1899, inclusive.

I have prepared here a table showing the average interest, rental, and dividends paid by the Chicago & Alton for the six years ending December 31, 1899. The average yearly return upon the capitalization in the way of dividends and interest and rentals amounted to \$2,495,000. There are some odd figures, but I use only the round numbers.

The average annual interest charge and dividends on the securities taken over by the syndicate—that is, \$32,000,000 of the 3 per cent bonds, \$22,000,000 of the 3½ per cent bonds, and \$20,000,000 of the 4 per cent preferred stock has been for the six years, since the syndicate took over the property, \$2,530,000. But having included rentals in the statement of returns upon capital for the six years prior to December 31, 1899, in order to make the comparison complete I add for rentals \$225,000, which is the average during the six years since the acquisition of the property by the syndicate, bringing the total average annual payment up to \$2,755,000, or \$279,865 per annum greater than it was prior to 1899. Now, against this excess—

Commissioner LANE. Pardon me. Those figures do not agree with Mr. Cravath's, do they?

Mr. LOVETT. I really do not know. I do not think he used those figures.

Mr. CRAVATH. They are arranged differently, but I think they are the same.

Mr. LOVETT. This is the average for a period of six years. I compare the sixth year following the acquisition of the property by the syndicate with the average for six years before.

Commissioner LANE. Does not that include interest on all the bonds and all the dividends that were paid?

Mr. LOVETT. During the six years?

Commissioner LANE. Yes.

Mr. LOVETT. It does, according to my understanding.

Commissioner LANE. Was there a variation at that time in the dividends that were paid and in the interest that was paid on the bonds?

Mr. LOVETT. There were some other securities issued; for instance, that \$5,350,000 in addition to the \$32,000,000; but I am taking the amount paid on the securities that the syndicate took and contrasting it with the amounts paid on securities that were outstanding before, and, as I say, annual disbursements were \$259,000 per annum greater after the syndicate acquired the property than before.

Now, the syndicate put into the property at once, as shown by the evidence here and by the statements of Mr. Hillard, \$5,559,000. The figures I have are \$5,745,000, compiled by Mr. Mahl, who tells me—and there is a statement from him in the record—that in Mr. Hillard's statement he failed to take into account certain expenditures that were made.

Mr. KELLOGG. What is that, Judge Lovett? I did not hear you.

Mr. LOVETT. I say that Mr. Hillard's statement, at page 179, gives the cash that went into the treasury and was subsequently applied to betterments and improvements out of this issue of \$32,000,000 of bonds as \$5,526,218. Mr. Mahl, who prepared the statement I have, gives it as \$5,745,432. There is a table here from Mr. Mahl, which I can not put my hands on at the moment, that gives the basis of his computation. I use his figures, assuming that they are correct. There was new capital of \$5,745,000, being part of the proceeds of the \$32,000,000 of bonds that went into the treasury and was expended on the road.

In addition to that, there was the Springfield-Peoria line, costing \$3,000,000, that went in against these securities. Part of these securities went to pay for that.

Mr. KELLOGG. What did that cost?

Mr. LOVETT. Three million dollars, as all the testimony agrees, undisputed in the record. That makes \$8,745,000.

Now, to digress a moment. The 3 per cent bonds sold

at 65, running for fifty years. That was equivalent to borrowing money at 4.87. That is to say, for the \$20,800,000 which the company got as the proceeds of the \$32,000,000 of bonds at 65, if it had issued bonds for the same period bearing interest at 4.87 per cent and sold them at par the result to the company would have been the same.

In this table I have compiled we have computed the interest on the \$5,700,000 of new money on that basis of 4.87 per cent. On the $3\frac{1}{2}$ per cent bonds the interest rate would be 4.84 per cent. Of course the Commission understands that there is a regularly established basis recognized in the financial world for measuring the value of bonds, depending upon the rate of interest and the time for which they run, and these figures are compiled on that basis.

The interest charge upon that new capital, the \$5,700,000 in cash and the \$3,000,000 of the Peoria line, making a total of \$8,700,000 at the rates I have indicated, amount to \$425,002 per annum.

Therefore the return on the capital invested in the property is \$165,000 less than it would have been if the new money put in had been raised prior to the recapitalization.

I have furnished counsel with a copy of that table, and I will leave it with the Commission.

(The paper referred to is as follows:)

CHICAGO & ALTON.

Average interest, rentals, and dividends for six years (Dec. 31, 1894, to Dec. 31, 1899)-----		\$2, 495, 149. 20
Annual interest charges and dividends on the securities taken over by the syndicate:		
\$32,000,000 C. & A. R. R. 3		
per cent bonds-----	\$960, 000. 00	
\$22,000,000 C. & A. Rwy. $3\frac{1}{2}$		
per cent bonds-----	770, 000. 00	
\$20,000,000 C. & A. Rwy. 4		
per cent preferred stock----	800, 000. 00	
	2, 530, 000. 00	
Rentals -----	225, 015. 00	
		2, 755, 015. 00
Excess (assuming the entire \$74,000,000 securities outstanding)-----		259, 865. 80

Against this excess should be credited:

Interest on \$5,745,432 new capital, being part of the proceeds of the \$32,000,000 of 3 per cent bonds applied to betterments, improvements, and additions, at the rate of interest which the 3 per cent bonds sold yielded if carried to maturity, viz, 4.87 per cent-----	\$279, 802. 54	
Interest on \$3,000,000 (being part of the proceeds from the sale of \$22,000,000 3½ per cent bonds paid for the Springfield & Peoria Railway), at the rate of interest which the 3½ per cent bonds yielded if carried to their maturity, viz, 4.84 per cent-----	145, 200. 00	\$425, 002. 54
Gain under recapitalization-----	165, 136. 74	
Average interest, rentals, and dividends for six years (Dec. 31, 1894, to Dec. 31, 1899)-----	2, 495, 149. 20	
Interest, rentals, and dividends for the year ending June 30, 1906-----	3, 228, 864. 69	
Increase-----	733, 715. 49	
Against this increase should be credited:		
Interest on \$19,183,396.19 capital expenditures from years ending June 30, 1900, to June 30, 1906, capitalized at 4.87 per cent (the yield of 3 per cent bonds if carried to their maturity) -----	\$934, 231. 38	
Interest on \$3,000,000 paid for Springfield & Peoria Railway, capitalized at 4.84 per cent (the yield of the 3½ per cent bonds if carried to their maturity)-----	145, 200. 00	1, 079, 431. 38
Gain under recapitalization-----	345, 715. 89	
APRIL 1, 1907.		

Commissioner CLEMENTS. That calculation is based entirely, and you get that result, on the fixed charges—that is, the interest on these bonds?

Mr. LOVETT. Yes, sir.

Commissioner CLEMENTS. You make no allowance for any dividends on stock?

Mr. LOVETT. On the common stock, no. I do take into account the preferred stock. That includes interest on the two issues of bonds and the 4 per cent dividends on the preferred stock, but nothing on the common stock.

Commissioner CLEMENTS. Nothing on the common stock?

Mr. LOVETT. No, sir.

Commissioner CLEMENTS. The common stock of this company, before it was reorganized, paid 8 per cent?

Mr. LOVETT. Yes, sir. Of course in computing what has been paid on the capital we take into account the dividends. It is wholly immaterial, from the public standpoint, I take it, whether what has gone to the holders of the securities of the company was in the form of dividends or in the form of interest.

Commissioner LANE. What is the exact figure you say the company pays now, or that the company has paid for the six years?

Mr. LOVETT. I have here only the average for the six years. The average during the latter period of six years was \$2,755,015, as against \$2,495,149 before.

Commissioner LANE. \$2,400,000, practically \$2,500,000.

Mr. LOVETT. \$2,495,000. Leaving an excess—that is, a greater amount to be paid by the public upon the new securities of \$259,000; but over \$8,000,000 of new capital went into the plant—that is, was added to the property as the result of this recapitalization and, computing interest upon that new capital on the basis I have indicated, would make the gain under recapitalization \$165,000 a year.

Commissioner CLEMENTS. But if this new common stock is ever to earn anything, it would increase the

charge on the public, of course, to the extent that it did get anything.

Mr. LOVETT. Undoubtedly. The value of the common stock is entirely speculative. There may be a fortunate condition, a great development of business, under reasonable rates that would pay a good dividend on the common stock. The stockholder takes his chances. He pays now, according to the present quotation, about 15 cents on the dollar for that chance. He has paid on an average, I think, since the stock was issued not over 30 cents on the dollar for that chance. That is a speculative chance.

Commissioner HARLAN. Mr. Lovett, could the control of the company be had through the common stock only?

Mr. LOVETT. No; it would require some of the preferred.

Commissioner LANE. May I ask you if you can reconcile, make clear to me, the figures that you have given and the figures that appear on page 12 of Mr. Cravath's statement, in which he says that the average annual amount which the Chicago & Alton Railroad Company had been paying out in interest and dividends for many years prior to the reorganization was \$2,906,000? The annual fixed charges as of June 30, 1906, including interest upon all obligations, rentals, and 4 per cent dividends upon the preferred stock, were \$3,228,000, an increase of only \$321,000. There seems to be a variance there of about \$70,000 or \$60,000.

Mr. CRAVATH. In dealing with the past I took a longer period, Mr. Commissioner.

Commissioner LANE. Mr. Lovett makes the figures \$2,495,000.

Mr. CRAVATH. I took a much longer period. Mr. McClement prepared these figures, and went back much longer than six years.

Commissioner LANE. Did they pay more in the olden times than they did latterly?

Mr. CRAVATH. Yes; they averaged more than 8 per cent for a considerable period.

Mr. LOVETT. They paid 10 per cent for a while, and they had not paid less than 8 per cent for eighteen years, until just two years before the syndicate bought.

Then as to the annual returns since the syndicate acquired the property, I presume Mr. Cravath included the entire amount of these 3 per cent bonds outstanding.

Mr. CRAVATH. Yes.

Mr. LOVETT. Probably car-trust obligations.

Mr. CRAVATH. Yes.

Mr. LOVETT. As they did not enter into the transactions of the syndicate, but were issued in the ordinary course of business, like any other railroad issues obligations for additional money, I have excluded them from my calculation.

Mr. KELLOGG. You had to pay interest on them, did you not?

Commissioner LANE. Pardon me a moment. If you reduce the average from \$2,900,000, the amount in Mr. Cravath's statement, to \$2,500,000, the amount in your statement, and make a difference of \$400,000 in the increase, instead of the increase being, according to his figure, \$320,000, it should be \$720,000.

Mr. CRAVATH. I think another difference was largely due to the fact that the accountant who prepared my figures took in the interest on guaranteed stocks at both points. The result of the comparison is the same, but it makes the figures different.

Mr. LOVETT. There has been no change, though, in the guaranteed stocks. They are outstanding just the same, as I understand. They are excluded from this calculation, because if you include them in one period you have to include them in the other. In my figures they are excluded from both periods; and then, as I said a moment ago, I have no doubt Mr. Cravath's figures include the interest on the rest of the 3 per cent bonds in excess of the \$32,000,000, and probably interest on car-trust obligations and securities of that sort that had nothing to do with the readjustment.

Mr. CRAVATH. They include all the interest when this statement was prepared.

Mr. LOVETT. I take the payments on the new securities that the syndicate received, and I add to that the interest on the money which the syndicate undoubtedly put into the property, leaving out money that was realized from the sale of these other securities that are included in Mr. Cravath's statement.

Another statement here that I will leave compares the business of the company during the same period—six years before and six years after. I shall not dwell upon that, but I call attention to the fact that during that period the gross receipts of the company increased from \$6,292,000 to \$11,586,000.

The tons of freight carried 1 mile increased from 423,000,000 tons to 1,174,000,000 tons. I use only the round sums. The average receipts per ton per mile were reduced from \$917 to \$639.

Mr. KELLOGG. Let me have that statement, will you? I have not had a chance to examine it. I only saw it this morning.

Mr. LOVETT. Certainly. Now, I think a great deal depends upon the method by which this was done. These gentlemen undertook to readjust the finances of this company in a somewhat unusual way. If they, when they bought these securities, had held them a year or two until those old bonds, bearing 7 and 8 per cent interest, matured, as they were about to mature, and had sold out that property under foreclosure and probably with a receivership and had bought it themselves and organized a company and conveyed this property to it and issued these securities against it, I do not believe anybody would have had a word to say against it. That is the usual and the ordinary way. The securities would not have been worth any more in the market. The legal effect would have been the same. The whole situation would have been then just as it is to-day, and I do not believe there would have been a word of criticism about it.

Commissioner CLEMENTS. Well, it would be a very unusual thing for a company the earnings of whose road were sufficient to pay 8 per cent for eighteen years or so to allow their road to be foreclosed and sold at

public sale. That would be a very extraordinary thing, would it not?

Mr. LOVETT. I do not know. Usually when they are paying large dividends they do not go into receiver-ships; but I think there are instances of that sort, many of them. They might have done it that way. The situation admitted of many methods of handling. The stockholders could have put a mortgage on the road and raised money to refund this indebtedness, or instead of putting a new mortgage on the property they could have waited until the bonds matured and then bought the property in.

That is all, if the Commission please, I have to say with reference to the Chicago & Alton matter.

Coming now to the relations of the Union Pacific and Southern Pacific, I want to call the attention of the Commission to the important fact, at the outset, that this is not another Northern Securities case, that it is wholly different, in matters of fact and in matters of law. The Great Northern and Northern Pacific railroads were two great systems extending from the Lakes to the Pacific Ocean, substantially alongside of each other, not only parallel, but competitive. There was scarcely a foot of that vast territory that was not competitive between those two roads; and any union of those lines naturally meant the elimination of all possibilities of competition between them. That is not the situation of the Union Pacific and Southern Pacific. They are connecting, not competing lines. They serve different territories. Where their lines are geographically parallel, a thousand or more miles intervene, which is covered with a network of competing lines. The physical situation, the facts, are totally different.

The relations between the Union Pacific and the Southern Pacific arise wholly from the purchase and ownership by the former of about 45 per cent of the stock of the latter. All their relations flow from that fact. The election or appointment of the same persons to many of the more important offices and positions of the two companies is due to it. The unity of

methods and, in many respects, of management, is due to that fact. No court of the United States has yet held that the purchase and ownership of the shares of one railroad company by another, even if they should own competing lines, is a violation of the antitrust act. I do not mean to say that if the lines were directly competitive and the purchase was for the very purpose of restricting or suppressing that competition, such purchase would not be within the act. That is an open question, and the facts in our situation do not present it. Such a purchase might be the result of a conspiracy. The act prohibits a "conspiracy in restraint of trade," a "combination in restraint of trade," and a "contract in restraint of trade"—that is to say, a contract designed and intended to restrain trade. The act nowhere in express terms prohibits a bona fide purchase of the stock of one corporation by another corporation having the requisite power, without any purpose to restrict or suppress competition, although such may be the effect though not the object of the purchase. That, as I have already indicated, is an open question.

It is well to bear in mind that the decision of the Supreme Court in the Northern Securities case proceeded solely upon the ground that the organization of the Northern Securities Company and the transfer of the stock of the Great Northern and Northern Pacific to it in exchange for its own shares, did not involve a purchase and sale, but that the transaction was the result of a conspiracy and was but a means to accomplish the object and end of the conspiracy. That is to say, it found that the persons in control of the two competing railroads set about to devise means for suppressing competition between them, and as a result of their conferences, and in furtherance of the conspiracy thus formed they organized the Northern Securities Company and transferred their shares to it. This being established, the court held that the conspiracy was unlawful and, as a consequence, that the Northern Securities Company was a mere agency employed to carry out and accomplish the

unlawful object. This is well illustrated by passages from Mr. Justice Harlan's opinion.

At page 333 of the report Justice Harlan said:

"It is said that whatever may be the power of a State over such subjects, Congress can not forbid single individuals from disposing of their stock in a State corporation, even if such corporation be engaged in interstate and international commerce; that the holding or purchase by a State corporation or the purchase by individuals of the stock of another corporation, for whatever purpose, are matters in respect of which Congress has no authority under the Constitution; that, so far as the power of Congress is concerned, citizens or State corporations may dispose of their property and invest their money in any way they choose, and that in regard to all such matters citizens and State corporations are subject, if to any authority, only to the lawful authority of the State in which such citizens reside, or under whose laws such corporations are organized. It is unnecessary in this case to consider such abstract, general questions. The court need not now concern itself with them. They are not here to be examined and determined, and may well be left for consideration in some case necessarily involving their determination."

Again:

"In this connection it is suggested that the contention of the Government is that the acquisition and *ownership* of stock in a State railroad corporation is itself interstate commerce if that corporation be engaged in interstate commerce. This suggestion is made in different ways—sometimes in express words, at other times by implication. For instance, it is said that the question here is whether the power of Congress over interstate commerce extends to the ownership of the stock in State railroad companies by reason of their being engaged in such commerce. Again, it is said that the only issue in this case is whether the Northern Securities Company can acquire and hold stock in other State corporations. Still further, it is asked, generally, whether the organization or ownership of railroads is not under the control of the States under whose laws they came into existence. Such statements as to the issues in this case are, we think, wholly unwarranted and are very wide of the mark; it is the setting up of mere men of straw, to be easily stricken down. We do not understand that the Government makes any such contentions or takes any such positions as those state-

ments imply. It does not contend that Congress may control the mere acquisition or the mere ownership of stock in a State corporation engaged in interstate commerce. Nor does it contend that Congress can control the organization of State corporations authorized by their charters to engage in interstate and international commerce. But it does contend that Congress may protect the freedom of interstate commerce by any means that are appropriate and that are lawful and not prohibited by the Constitution."

One more paragraph and then I will stop. Turning to page 353—

"It was said in argument that the circumstances under which the Northern Securities Company obtained the stock of the constituent companies imported simply an investment in the stock of other corporations, a purchase of that stock, which investment or purchase, it is contended, was not forbidden by the charter of the company and could not be made illegal by any act of Congress. This view is wholly fallacious and does not comport with the actual transaction. There was no actual investment, in any substantial sense, by the Northern Securities Company in the stock of the two constituent companies. If it was in form such a transaction, it was not in fact one of that kind. However that company may have acquired for itself any stock in the Great Northern and Northern Pacific Railway companies, no matter how it obtained the means to do so, all the stock it held or acquired in the constituent companies was acquired and held to be used in suppressing competition between those companies. It came into existence only for that purpose. If anyone had full knowledge of what was designed to be accomplished, and as to what was actually accomplished, by the combination in question, it was the defendant Morgan."

It is true that in the subsequent case of *Harriman* against the Northern Securities Company (197 U. S., 244) the court said that was a sale as between the parties. That was a question where one of the parties who delivered stock to the Northern Securities Company was contending that it was not a sale, and that the whole transaction should be rescinded because the scheme had been held to be illegal, but no court has ever yet held, so far as I know, that a bona fide purchase of the stock

of one corporation by another corporation is in violation of the antitrust act.

Our contention upon the facts, briefly stated, is that the Union Pacific and Southern Pacific are not competing lines, but are connecting lines; that aside from the connection at Ogden, where the rails of the transcontinental lines unite, the only common point of the two systems is at Portland, Oreg.; that the two systems do not serve the same territory, but that so far as their lines are geographically parallel they are 1,000 miles or more apart, with a perfect network of competitive railroad lines traversing the territory between them; that if there was any traffic admitting of competition, the volume of such competitive traffic is so small in comparison with the total tonnage and revenue of each and both of the systems as to be trifling and insignificant, and that if there has been any restriction or suppression of such insignificant competition it has been a remote, indirect, and legally unimportant result of their present relations; and that the antitrust act does not prohibit such remote and indirect effects of otherwise lawful transactions.

Before taking up the facts in detail for discussion, my argument perhaps can be better understood and appreciated if I present briefly certain legal propositions which seem to me to control. I do not intend to discuss questions of law and the authorities extensively, but shall leave the elaboration of them to my associate. In *United States v. Joint Traffic Association* (171 U. S., 505) the Supreme Court declared that the antitrust act applies only to those contracts or combinations the direct and immediate effect of which is a restraint upon interstate commerce and that the suppression or restriction prohibited must not be merely indirect or incidental. In answer to the argument of eminent counsel that the construction placed upon the statute in the *Trans-Missouri Association* case would disrupt as unlawful many of the most familiar and necessary business relations, the court said (p. 568):

“The instances cited by counsel have in our judgment little or no bearing upon the question under considera-

tion. In *Hopkins v. United States*, decided at this term (post, 578), we say that the statute applies only to those contracts whose direct and immediate effect is a restraint upon interstate commerce, and that to treat the act as condemning all agreements under which, as a result, the cost of conducting an interstate commercial business may be increased would enlarge the application of the act far beyond the fair meaning of the language used. The effect upon interstate commerce must not be indirect or incidental only. An agreement entered into for the purpose of promoting the legitimate business of an individual or corporation, with no purpose to thereby affect or restrain interstate commerce, and which does not directly restrain such commerce, is not, as we think, covered by the act, although the agreement may indirectly and remotely affect that commerce. We also repeat what is said in the case above cited, that 'the act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce and possibly to restrain it.' To suppose, as is assumed by counsel, that the effect of the decision in the *Trans-Missouri* case is to render illegal most business contracts or combinations, however indispensable and necessary they may be, because, as they assert, they all restrain trade in some remote and indirect degree, is to make a most violent assumption and one not called for or justified by the decision mentioned or by any other decision of this court."

And in the *Hopkins* case (171 U. S., 578) the court, in addition to the language quoted above, also said (p. 594):

"An agreement may in a variety of ways affect interstate commerce, just as State legislation may, and yet, like it, be entirely valid, because the interference produced by the agreement or by the legislation is not direct."

And in support of this the court cites many of its previous decisions dealing with State legislation which affected interstate commerce, but which, notwithstanding the power of Congress over such commerce, were held to be valid because the interference thereby with interstate commerce was merely incidental and was not a direct regulation. Thus, the court puts contracts which may indirectly and incidentally restrain inter-

state commerce upon the same basis with respect to validity as legislation of the states, of which there are numerous examples, which incidentally and indirectly affect interstate commerce and yet are valid because such effect is not a direct regulation of such commerce.

We come then directly to the consideration of the circumstances under which and the purposes for which the Union Pacific acquired the stock of the Southern Pacific.

Now, we all understand that if the manufacturers or dealers in a certain commodity get together and make a contract that the prices shall be maintained at a certain rate, that is a contract in restraint of trade. We know from the decisions of the Supreme Court that if a number of competing railroads get together for the very purpose, as found by the courts in both of these cases, of restricting competition, not suppressing it, perhaps, absolutely, but restricting it and embarrassing it, that is a "combination" or "conspiracy" in restraint of trade; but when a corporation or firm or individual, in the exercise of the important right to acquire property, actually buys the stock of a competing corporation, it is not a contract in restraint of trade, but is an exercise of the right to acquire property, and if restriction in competition results it is a mere incidental and indirect effect and result of the exercise of a lawful right.

Commissioner CLEMENTS. Suppose the motive was to get rid of the competition; would you say the same thing?

Mr. LOVETT. I believe there would still be the right. I have never considered that very thoroughly, because I have not felt that it was called for by our case; but the courts have certainly held that in respect to individuals—how far that would extend to railroad corporations I do not know, I am not prepared to say at the moment; but take the case of competing tradesmen and manufacturers—each owns absolutely his own property. They can not get together and fix prices, because that would be in restraint of trade; but the owner of property has, as it seems to me, the right to enjoy every

incident and legitimate profit of that ownership. If to protect that property he buys out the other man, the elimination of competition is the motive of the purchaser, yet it is lawful. The vendor may have made himself a nuisance as a competitor. Did he not have the right to do it? Has not the owner of the property the right, as the owner of that property, to cut the price and make it to the interest of his competitor to buy him out?

I think those questions follow inevitably the right to own and acquire property; but I have not considered that aspect of it thoroughly, because I felt that it was not necessary, in view of the facts of this case.

Commissioner CLARK. Would you carry that personal and individual right to its full extent, as applied to a public service corporation?

Mr. LOVETT. The right to own stock of a corporation?

Commissioner CLARK. The right to buy the competing property.

Mr. LOVETT. Assuming that it has power under its charter, by the law of the State that created it, to buy it?

Commissioner CLARK. And that the suppression of competition that might result would be considered as purely incidental and beyond the reach of the law?

Mr. LOVETT. I am inclined to that opinion.

Commissioner LANE. Is not that contrary to the Addyston Pipe case?

Mr. LOVETT. No; the Addyston Pipe case involved an agreement among certain manufacturers to divide a certain territory among themselves and not compete against each other.

Commissioner LANE. They put it in a common holding, did they not?

Mr. LOVETT. No, sir.

Mr. MILBURN. No; it regulated production.

Mr. LOVETT. It did not involve the ownership of property, as I understand. It was a contract.

Commissioner LANE. Just simply a contract, was it?

Mr. LOVETT. That is my recollection, and that accords with the recollection of Mr. Cravath and others.

But I am really arguing beyond the necessity of the facts in this case, because I do contend that the authorities are conclusive on the proposition that where the restriction in competition is merely indirect, incidental, and remote, it is not within the act, and the facts unquestionably bring our case within that rule.

That is as far as it is necessary for me to go now, that such restriction of competition as resulted was a mere indirect, incidental, and remote result, and a circumstance so trifling in comparison that it is without any legal importance, and that there could not have been in the minds of those people, in making the transaction, any thought of suppressing or restricting competition.

Now, to take up the situation of these lines I should like to call the attention of the Commission to the fact that the system of railroads extending from the Missouri River, at Omaha and Kansas City, to the Pacific Ocean, made up of the Union Pacific and the Central Pacific lines, is a single system; and I want, in that connection, to call the attention of the Commission to the purpose for which those roads were constructed and the legislation under which they were constructed.

The lines of the Union Pacific, beginning on the Missouri River in the east and ending at Ogden, Utah, on the west, and of the Southern Pacific continuing from a connection with the Union Pacific at Ogden to San Francisco and various points in California, were built under the same act of Congress. Every share of the capital stock of the Central Pacific Railway Company is owned by the Southern Pacific Company. The lines of both the Central Pacific and the Union Pacific were built under the act of Congress approved July 1, 1862, entitled "An act to aid in the construction of a railroad and telegraph line from the Missouri River to the Pacific Ocean," etc., and the various acts of Congress amending and supplementing such original act. The original act, as is well known, incorporated the Union Pacific Railroad Company and provided for the construction by it of a railroad from the Missouri River in Nebraska and of other railroads by other companies

from the Missouri River in Kansas westerly toward the Pacific Ocean; and by section 9 of the act it was provided:

“The Central Pacific Railroad Company of California, a corporation existing under the laws of the State of California, are hereby authorized to construct the railroad and telegraph line from the Pacific coast at or near San Francisco, or the navigable waters of the Sacramento River, to the eastern boundary of California upon the same terms and conditions in all respects as are contained in this act for the construction of said railroad and telegraph lines first mentioned”—

That is, the Union Pacific Line—

“and to meet and connect with the first-mentioned railroad and telegraph line”—

That is, the Union Pacific—

“on the eastern boundary of California.”

A further provision in the same paragraph reads as follows:

“And in case the said first-named company shall complete their line to the eastern boundary of California before it is completed across said State by the Central Pacific Railroad Company of California”—

That is, if the Union Pacific should get to the California border before the Central Pacific got there—

“said first-named company (the Union Pacific) is hereby authorized to continue in constructing the same through California, with the consent of said State, upon the terms mentioned in this act until the said roads shall meet and the whole line of said railroad and telegraph is completed. And the Central Pacific Railroad Company of California, after completing its road across said State, is authorized to continue the construction of said railroad and telegraph through the Territories of the United States to the Missouri River, including the branch roads specified in this act, under the same conditions as to land grants and everything else.”

The act also provided, in section 12, that the gauge should be uniform and should be fixed by the President of the United States.

Section 16 of the act provided as follows:

"That at any time after the passage of this act all of the railroad companies mentioned herein and assenting hereto, or any two or more of them, are authorized to form themselves into one consolidated company. Notice of such consolidation, in writing, shall be filed at the Department of the Interior," etc.

Thus the Central Pacific, which owns the road from Ogden to the Pacific Ocean and to various points in California, was authorized by the act of July 2, 1862, to consolidate with the Union Pacific and the Kansas Pacific and the Denver Pacific. In the exercise of the power conferred by this section, the Kansas Pacific and the Union Pacific and the Denver Pacific were consolidated. They were competing lines in the sense that they were parallel. There was considerable space intervening between them, but no other lines at that time, and they were fairly competing, I think. Each had the power under this act to build across the continent from the Missouri River to the Pacific Ocean. Congress authorized them to consolidate. The Central Pacific was not included in the consolidation. It was owned by different interests. Probably they could not agree upon terms or probably there was rivalry between the two companies as to the construction of their lines. At all events, for some reason I do not understand, and into which I have never had occasion to inquire, they did not consolidate, but that system of railroads was intended as a single system. The Government granted the land and gave its aid in money for the purpose of establishing a single system of railroads between the Missouri River and the Pacific Ocean.

Section 16 of the amendatory act of July 2, 1864, provided:

"That the several companies authorized to construct the aforesaid roads are hereby required to operate and use said roads and telegraph for all purposes of communication, travel, and transportation, so far as the public and the Government are concerned, as one continuous line."

Section 1 of the joint resolution of Congress approved April 10, 1869, provided:

“That the common terminus of the Union Pacific and the Central Pacific roads shall be at or near Ogden”—

They were completed to that vicinity then—

“and the Union Pacific Company shall build and the Central Pacific Company shall pay for and own the railroad from the terminus aforesaid”—

That is, from Ogden—

“to Promontory Point, at which point the rails shall meet and connect, and form one continuous line.”

By the act of June 20, 1874, section 15, requiring it to be used as one line, was amended by adding a provision making it a penal offense not to use it as one continuous line. It provides:

“That any officer or agent of the companies authorized to construct the aforesaid roads, or any company engaged in operating either of said roads, who shall refuse to operate and use the road or telegraph under his control, or which he is engaged in operating, for all purpose of communication, travel, and transportation, so far as the public and the Government are concerned”—

Using the language of the preceding paragraph—

“as one continuous line, shall be deemed guilty of a misdemeanor,” etc.

It is perfectly manifest from this legislation that this was designed by Congress as a single system of railroad although constructed by a number of separate corporations, if they preferred to do it that way. Congress was utilizing all of the agencies then available to build this system of railroads. If instead of working separately they had preferred to work as one, they were given the right to consolidate, but whether consolidated or not they were required by this act, under a penal provision, to use it as one continuous line. That is the conspicuous purpose and feature of this legislation all the way through.

Now, as I have said, the Central Pacific and the Union Pacific were never consolidated. They both had other difficulties with the Government in meeting their

indebtedness. The Central Pacific's indebtedness, I think, matured along in 1896, 1897, or 1898, or thereabouts, most of it. The Southern Pacific, I think, had secured control of it prior to that time, or certainly the individuals who held a majority of the stock of the Southern Pacific controlled it. The Union Pacific had gone into bankruptcy, and in 1897 emerged from its receivership with its present organization. The Central Pacific was then engaged in an effort to settle its indebtedness to the Government, which finally resulted in an agreement of February 1, 1899, by which it undertook to pay its indebtedness and secured it by a deposit of bonds, etc.

That was February 1, 1899, that the agreement between the Central Pacific and the Government for the settlement of its indebtedness was made. The readjustment of the indebtedness of that company, the issuance of the new securities, the taking up of the old and the launching of the company anew occurred in August, 1899, soon after the agreement with the Government was made. That debt was paid by the Central Pacific because the Southern Pacific was behind it. It was the principal agency in effecting the settlement of the debt to the Government. As a part of the readjustment plan the Southern Pacific Company acquired every share of the stock of the Central Pacific, and it deposited every share of that stock under the mortgage to the Union Trust Company, which I introduced in evidence this forenoon, to secure an issue of bonds that mature in 1949. That welded the Southern Pacific and the Central Pacific together.

Such was the situation existing when, in 1900, negotiations were commenced by Mr. Harriman and his associates controlling the Union Pacific, with the late C. P. Huntington, who with his associates controlled the Southern Pacific, for the union of ownership of this "continuous line." Huntington died in August, 1900, but negotiations were taken up with his legatees and others, which resulted in the purchase in February, 1901, of \$75,000,000 par value out of a total of approximately \$195,000,000 of the capital stock of the Southern

Pacific Company, to which by purchase the following year, I believe, there was added \$15,000,000 more, bringing the ownership by the Union Pacific to \$90,000,000 out of approximately \$195,000,000. There was no other way by which the unification of ownership of this single system of railroads from the Missouri River to the Pacific Ocean could be effected. The Southern Pacific had neither the means nor the credit to buy the Union Pacific. It was a holding company, with practically all its assets placed for their full value. The Union Pacific could not buy the Central Pacific. The latter was not upon the market. It was vital to the Southern Pacific. As already indicated, every share of its stock was owned by the Southern Pacific, and had been pledged by the latter with the Union Trust Company of New York as collateral to secure, and as the only security for an issue of 36,000,000 of its 4 per cent bonds not maturing until 1949.

Obviously, therefore, the only way the Union Pacific Railroad Company could acquire control of that portion of the system extending westerly from Ogden was to purchase the stock of the Southern Pacific Company, which owned all the stock of the Central Pacific Railroad Company and controlled it.

The Southern Pacific Railroad lines begin on the Mississippi River at New Orleans and stretch away westwardly through Louisiana, Texas, skirting the Mexican border, through New Mexico and Arizona to Los Angeles, and thence northerly through California and Oregon to Portland, with the Central Pacific lines extending eastwardly from San Francisco to Ogden, Utah. The Union Pacific lines begin on the Missouri River at Omaha and Kansas City and extend westwardly through Kansas, Nebraska, Colorado, Wyoming, and Utah to Ogden, with the Oregon Short Line running from Salt Lake City northerly through Idaho and into Montana and connecting with the lines of the Oregon Railroad & Navigation Company, extending to Portland. Neither system owns a mile of railroad east of the Missouri and Mississippi rivers. Neither penetrates that vast region lying between those rivers

and the Atlantic Ocean. Between their lines where geographically parallel lie most of the States of Louisiana, Texas, Kansas, Colorado, the Territories of Arizona and New Mexico, and all of Oklahoma, Arkansas, Mississippi, Tennessee, Kentucky, Missouri, Illinois, and Iowa. The Southern Pacific operates a line of steamers from New York to New Orleans and Galveston, where they interchange freight with the rail lines; and through this agency the Southern Pacific Company was largely engaged in transcontinental traffic from the Atlantic seaboard, the Gulf States, and the Pacific coast. All of this traffic westbound which the Union Pacific formerly got or now gets is carried to it by the powerful trunk lines extending from the seaboard to Chicago, and thence via the lines of almost equal power from Chicago to the Missouri River. All this traffic which the Union Pacific gets eastbound is delivered to it by the Southern Pacific at Ogden, except possibly an unknown, because insignificant, amount originating at Portland, Oreg.

The Union Pacific is merely an intermediate carrier—a link of 1,000 miles in a transcontinental line of more than 3,000—and is obviously without any rate-making power. It is absolutely dependent upon the lines east of the Missouri River for all the westbound traffic it gets, and it is likewise dependent upon the Southern Pacific for all the westbound traffic from the Pacific coast which it gets. It was and is utterly powerless in the making of any transcontinental rate. It could not openly cut a rate if it would. If it should undertake to make a rate unsatisfactory to lines east of the Missouri River, they could refuse to recognize it and could turn their business to its rivals. The Atchison owns an unbroken line from Chicago to the Pacific Ocean, touching most of the principal points in California. Extending from Chicago to a connection with the Denver & Rio Grande system at Denver or Pueblo are the Burlington, the Rock Island, the Atchison, and from the Missouri River the Missouri Pacific. All these lines west of the Missouri River are fiercely competitive with the Union Pacific. In connection with

the Denver & Rio Grande they reach Salt Lake City and Ogden, where there is connection with the Southern Pacific. Thus the trunk lines from the Atlantic to Chicago and the Missouri River were not dependent upon the Union Pacific.

Then, the Southern Pacific had the other end of the line—that is, between Ogden and the Pacific Ocean. The Union Pacific of course could make no rate west of Ogden without the consent of the Southern Pacific. It was at the mercy of the Southern Pacific. The latter could divert its unrouted traffic to the Denver & Rio Grande at Ogden and its eastern connections. It is impossible to suppose that thus holding the key the Southern Pacific would allow the Union Pacific to make any rate to California not acceptable to it.

In this situation can there be any doubt about the object or purpose of the Union Pacific in purchasing stock of the Southern Pacific? Is it not absurd to suppose that it was prompted by the purpose to eliminate the competition for seaboard business presented by the Southern Pacific boat line operating around the coast from New York to New Orleans, 1,400 miles away from the eastern terminus of the Union Pacific line? Would it not be singular for it to undertake, singlehanded and alone, such a vast transaction for the benefit of the powerful trunk lines extending from the seaboard to Chicago and the Missouri River, who were face to face with the competition of the Southern Pacific and the chief sufferers thereby? I submit as a proposition too plain to admit of serious dispute that any purpose to restrain competition could not reasonably have been a factor in the transaction. The whole purpose and object obviously was to get an outlet from Ogden, its western terminus, to the Pacific Ocean in California. As we have seen, it was at the mercy of the Southern Pacific. It could not reach California, except at rates dictated by the Southern Pacific. It could get only such share of the unrouted business from California and the Orient as the Southern Pacific saw proper to give it; the latter could distribute such business as it pleased at Ogden between the Union Pacific and the Denver & Rio

Grande. The Southern Pacific was unplaced financially and after the death of C. P. Huntington, in August, 1900, was known to be upon the market. Suppose the interests controlling the Burlington or the Rock Island or the Missouri Pacific in connection with the Denver & Rio Grande had acquired control of the Southern Pacific. What would have been the position of the Union Pacific and where would it be to-day? It would have been precisely where the Denver & Rio Grande finds itself—in a position where it is forced to build from Salt Lake across the Sierra Nevada ranges to the Pacific Ocean, and when it gets there it is still without tracks into all the industrial and shipping interests which have been built up along the tracks of the Southern Pacific in the thriving cities of California, whence comes such a rich and valuable traffic for the connection at Ogden favored by the Southern Pacific. It was to become the preferred connection of the Southern Pacific, thereby getting the unrouted traffic of the latter and to protect itself against the danger of the Southern Pacific falling into rival hands that the Union Pacific purchased the stock of the Southern Pacific. If the men who controlled the Union Pacific in the transaction were sane men, these were the considerations which it seems to me must be attributed to them, and that any purpose to restrict competition, insignificant as it must have been, could not have entered into the transaction at all.

But it may be said that the Southern Pacific also had a line from California to New York by way of the Sunset route and the rail line, and that that was engaged in competition with the all-rail lines. That is granted. The Southern Pacific had a position that was peculiarly valuable to it. It had the Sunset route, but it also had a transcontinental line, or a share in a transcontinental line, almost as great as the Union Pacific's line in length and a great deal more important in its strategic position because it had the choice of connections at Ogden. It could turn its traffic either way, to the Denver & Rio Grande or to the Union Pacific. It was not dependent upon either, and in

addition to that it had the Sunset route. The fact, if the Commission please, that is absolutely controlling in the consideration of this question, and a fact which, fortunately, is a physical fact that can not be ignored, is that the Southern Pacific owned the other end of this transcontinental line. It owned the line from Ogden to the Pacific coast, and no railroad company entering California, except the Atchison, could make a rate to California without the consent of the Southern Pacific. It held the key to the situation. The Union Pacific could not cut the rate without the consent of the Southern Pacific. The Southern Pacific of course would not allow a rate that would be detrimental to its Sunset line unless it was forced by the Atchison, which was in a position to make rates.

Now, I take it that before there can be any restriction of competition there must be competition. Competition must exist before it can be restricted or there must be the possibility of competition. The situation must admit of competition, as, for instance, in the Northern Securities case. But competition was impossible in this situation because the Union Pacific was not a parallel line to the Southern Pacific, but a connecting line.

It seems to me that physical fact, that the Southern Pacific owned the line from Ogden to the Pacific, is decisive of this question. It can not be avoided. It is there, and the Union Pacific could not compete with it because it was a connecting line, and it could not compete with this Sunset line of the Southern Pacific except in so far as the Southern Pacific was willing for it to compete. Why should it be willing for it to compete? Of course the Southern Pacific knew that there was a vast amount of this transcontinental traffic that would go all rail and that if the Union Pacific did not take it the Atchison would. It had 850 miles of road from Ogden to the Pacific that it wanted to use. It was a carrier by the rail route as well as the sea route. If it did not utilize its eastern connections to participate in this all-rail traffic across the continent, of course it would go to the Atchison. Therefore, occupying this

dual position, it joined its other rail connections in making the transcontinental rates, because it had 850 miles of road good only for that purpose and because it had to compete with the Atchison. Whatever business it could get that way it would readily take, because if it did not it would go to the Atchison. It left its eastern connections free, except that it would not allow that line to cut a rate against its Sunset line. In meeting the competition of the Atchison of course it would have to yield, because that was a competing line.

I am consuming more time than I had intended.

Mr. KELLOGG. May I ask a question?

Mr. LOVETT. Oh, yes.

Mr. KELLOGG. Do you consider the Burlington road and the Union Pacific as competing lines?

Mr. LOVETT. I think they are, probably, with respect to some local business. I am not as familiar with the Burlington line as I ought to be. I only have a very general knowledge of its situation.

But it is contended that the Union Pacific system was in a position to compete with the Southern Pacific for California business by its rail lines from the Missouri River to Granger or Ogden, and then over the Oregon Short Line to Huntington, and thence over the rails of the Oregon Railroad & Navigation Company to Portland, and thence by the boats of the last-named company between Portland and San Francisco. But every witness who has testified has declared that route utterly impracticable as a competitor for transcontinental business. After carrying business from Granger or Ogden to Portland, a haul of upward of 800 miles over a range of mountains, it is no nearer San Francisco than when it left Ogden; and the boats from Portland to San Francisco had no connections to get their business to or from the interior except the Southern Pacific, which, with respect to competitive business, would be a rival. Thus the boats would be confined strictly to San Francisco, and as between the short direct rail line of the Central Pacific to Ogden and the circuitous rail and boat line from Ogden to Portland and thence by sea to San Francisco, there is no difficulty in decid-

ing which route the traffic even of San Francisco proper would take.

Moreover, would not the Union Pacific have killed the goose that laid the golden egg if it had attempted to work the rail and water route via Portland against its direct connection, the Central Pacific line, between Ogden and San Francisco. At equal rates all the traffic would undoubtedly move by the short all-rail route. A reduced open rate would have been met of course by the Southern Pacific and the loss sustained by the Union Pacific as its share of the reduced rates would have exceeded, on account of the vastly greater volume of traffic moving that way, many thousandfold the profit on the business moving via Portland. But beyond all this is the practical fact that if the Union Pacific had attempted to work the Portland route against the Southern Pacific, the latter undoubtedly would have retaliated by turning its business to the Denver & Rio Grande, and the Union Pacific would have been practically out of the transcontinental business.

The best evidence of it, however, is that the testimony shows that long before the Union Pacific bought the Southern Pacific's stock the Union Pacific had the opportunity to use this line and it never used it.

My friend, Mr. Severance, asked a witness if that was not a club of some value to the Union Pacific to use against the Southern Pacific in exacting divisions of the through rate.

The witness disposed of that by saying that if the Union Pacific attempted to divert freight around by way of Portland, the Southern Pacific would of course retaliate by turning its business at Ogden over to the Denver & Rio Grande, and that the Union Pacific would get very much the worst of the contest; and it is perfectly obvious, it is perfectly plain it would be suicidal to the Union Pacific to attempt to use that route as against the Southern Pacific. I do not care what its motive is, the matter of divisions, or anything else. I shall not detain the Commission longer in discussing that, because I think that is disposed of.

Commissioner CLEMENTS. What would be the motive of the Union Pacific in buying into the Atchison? That is a competing road?

Mr. LOVETT. It would be as an investment, I take it, Mr. Commissioner. That was the motive.

Commissioner CLEMENTS. They bought into it sufficiently to have two directors in the management of it.

Mr. LOVETT. I do not so understand, Mr. Commissioner.

Commissioner CLEMENTS. That was Mr. Ripley's testimony.

Mr. LOVETT. I think not. Mr. Ripley stated that certain gentlemen who owned, according to his understanding, about 300,000 shares would have been entitled to two directors, and that they were accorded. The Union Pacific owns 100,000 shares.

Commissioner CLEMENTS. Those gentlemen are connected with the management of the Union Pacific?

Mr. LOVETT. Those that he named are. They are directors, but so far as such ownership of stock is concerned it was entirely an individual matter.

Commissioner LANE. Mr. Harriman, according to Mr. Ripley, went to Mr. Ripley and asked for those directors. Was not that it?

Mr. LOVETT. Yes.

Commissioner LANE. Mr. Harriman asked for an official of the Union Pacific to be made a director, and Mr. Ripley refused and said he would not consent to that, but would put in Mr. Frick and Mr. Rogers.

Mr. LOVETT. Yes, sir. Mr. Ripley's testimony, as I recall it, substantially was to the effect that Mr. Harriman told him that he and some of his friends had acquired a block of Santa Fe stock because they thought it was a good investment, and they would like representation on the board of directors. Mr. Ripley said that from such information as he gathered he made up his mind that they had between 250,000 and 300,000 shares of stock, and after discussing it with Mr. Morowitz and his associates they finally agreed to allow them two directors, because they could get that under the cumulative system of voting allowed under the laws of Kan-

sas, where the Atchison is incorporated; but Mr. Ripley's testimony was that they agreed upon the condition that they should not be officers of the Union Pacific or Southern Pacific.

Commissioner CLEMENTS. If the acquisition of that stock should go on until it was practically sufficient for the Union Pacific to control the Atchison, what difference would it make to the public what the motive was, whether it was an investment or whether it was to get rid of competition, if, in fact, it did get rid of competition?

Mr. LOVETT. That, of course, will be a very interesting question, Mr. Commissioner, if it ever arises. I think we are far from it now.

Commissioner CLEMENTS. Mr. Harriman said in New York that it would not take long to do it if the laws would allow him, or something of that sort; or perhaps he was just talking.

Mr. LOVETT. I think he readily conceded, however, that the law would not allow that.

Mr. SEVERANCE. You claim to-day that the law does allow it?

Mr. LOVETT. Yes.

Mr. SEVERANCE. So you do not agree with Mr. Harriman?

Mr. LOVETT. I think that is a fairly open question. Many people may not agree with Mr. Harriman as to legal questions; but we would then have the question whether a bona fide purchase or investment of one corporation in the stock of a corporation owning a competing line is contrary to the anti-trust act. But we have no such question now, and I think under the law as it stands it would not be a violation of the act. But I am not insistent upon that opinion, because I do not consider it material so far as this controversy is concerned.

Commissioner CLARK. If you carry it to its logical conclusion, would it not mean this, that any syndicate of men with sufficient money to carry the margins over and above the money they could borrow on the securities, so that they controlled the several corporations,

could continue until they owned every railroad in the United States?

Mr. MILBURN. Or owned all the real estate of the country?

Mr. LOVETT. I think if any man has money enough to own all the railroads, he has the right under the American Constitution to own them all. I do not know of any law that would prevent him, if he has the money to do it.

Commissioner CLARK. In reply to Mr. Milburn's suggestion, to my mind there is a distinct difference between the real estate of the country and the transportation facilities of the country.

Mr. MILBURN. What I meant was, you can undertake to buy anything that is purchasable.

Mr. LOVETT. That, of course, involves a rather interesting proposition, that we all may have various views upon, whether it is better for the Government to own the railroads, or whether it is better, as my old friend Judge Reagan, of the Texas Railroad Commission, believed it was better, merely to fix the rates. He said he was opposed to Government ownership of railroads, because "It is very much better for the people to let the individuals own them, and then we will fix the rates;" and I am not sure from the public standpoint but that is the best. But that is a question, as I say, that is beyond the scope of my argument to-day, as I am not dealing with what the laws should be, but what may be done under the laws as they are to-day.

Commissioner LANE. Your argument regarding the Union Pacific and the Central Pacific from Omaha to San Francisco is somewhat analogous to this, is it not? The Baltimore and Ohio and the Pennsylvania start out of Chicago. The Pennsylvania stops at Philadelphia. Assuming that the Pennsylvania wanted to reach tide water at Baltimore it would have the right to buy the Baltimore and Ohio road, because it could not get down to Baltimore without buying the Baltimore and Ohio road, and that would also give it the right then to go around from Baltimore back to Chicago and own that parallel competing line.

Mr. LOVETT. No, sir; I do not think that is analogous at all. That is a different situation. Those roads are competing. They serve the same territory, as I understand.

Commissioner LANE. They reach out for the same traffic in the West, do they not?

Mr. LOVETT. West of Chicago?

Commissioner LANE. Yes.

Mr. LOVETT. I presume they do.

Commissioner LANE. And for a great deal of territory in between Chicago and Pittsburg?

Mr. LOVETT. Yes.

Commissioner LANE. Would it be an illustration then, closer, if the Pennsylvania owned the road not only up to New York, but back of New York up to Buffalo, and the Lake Shore, which was an independent line, we will assume, wished to reach New York. Would it then be justified in buying the line from Buffalo to New York and back to Chicago by way of Pittsburg?

Mr. LOVETT. In all of those cases I take it that the restriction of competition would be the overshadowing effect of the transaction. In this case, if any competition is restricted, it is insignificant. I do not concede for a moment that this traffic, originating on the seaboard territory or anywhere east of the Missouri River, or along the line of the Union Pacific, is in competition between the Union Pacific and the Southern Pacific or ever was. It absolutely never was. It is in competition with the Atchison and the lines east of Chicago and the Southern Pacific, but it never was in competition between the Union Pacific and the Southern Pacific. Now, the traffic in the seaboard territory, that is, east of Pittsburg and Buffalo, and in New England, I readily concede has been and is today in competition between the Sunset route of the Southern Pacific and the all-rail lines. When I say all-rail lines I do not mean simply the Union Pacific, but the system of lines that pick up the traffic here at the Atlantic seaboard and take it to Chicago or the Missouri River. They will take it to California re-

gardless of the Union Pacific or Southern Pacific, because they can take it over the Atchison. The Southern Pacific recognized that the Union Pacific was a participating line in that traffic and joined with the Union Pacific in competing for it, but there never was any competition between the Union Pacific and the Southern Pacific for the traffic.

In the case you take, Mr. Commissioner, of the Pennsylvania wanting to get to the seaboard and buying the Baltimore & Ohio, I am dealing with practical issues, and I submit that is scarcely a parallel case, because it is obvious that two vast railroad systems competing with each other would be put together on the pretext of getting a line 40 or 50 miles in length to tidewater. The suppression of competition would overshadow the real purchase—entirely overshadow it.

That is not true here. I dissent entirely from the proposition that any of this traffic east of the Missouri River or that originating on the Union Pacific ever was in competition between the Southern Pacific and the Union Pacific. Absolutely, the physical facts forbid it. It is physically impossible for that traffic ever to have been in competition between those two systems. The competition was between the Atchison connecting with the lines east and the Southern Pacific. They could make the rates and they could do it without reference either to the Southern Pacific or the Union Pacific; and the Southern Pacific, owning 850 miles of this transcontinental line, joined the Union Pacific, owning 1,000 miles, in participating in the business, not as competitors, but as connecting lines.

Commissioner LANE. Take it at the other end. Take it at the San Francisco or the Pacific coast end, where the Sunset Route and the Central come together, or at Portland, where the Shasta and the O. R. & N. come together, or at Los Angeles, where the Southern and the branch of the Union running down south, come together. There is competition there, is there not?

Mr. LOVETT. Between the Southern Pacific and the Union Pacific?

Commissioner LANE. Yes; there is competition between the Southern Pacific and the Union Pacific as to how that business will get east, is there not?

Mr. LOVETT. Their lines operate there. Some of that traffic moves over channels. Take business from San Francisco: Business originating in San Francisco and destined for the Atlantic seaboard may go by the Atchison or by the Union Pacific-Southern Pacific lines, and it may go either way that the shipper sends it; but the Southern Pacific owns 850 miles of the all-rail line, and its consent is absolutely indispensable to any rate made by the Union Pacific, because the Union Pacific is without rate-making power in that situation. The Southern Pacific owns 850 miles of this road—the western end. Suppose instead of the Union Pacific buying the Southern Pacific the Southern Pacific had bought the Union Pacific; it would simply have been extending its line from Ogden to the Missouri River. That would have been the result. There would have been no suppression of competition in it. It would have been merely extending its line by purchase to the Missouri River.

Now, the Atchison is a factor in this transcontinental situation. With its connections east of Chicago it makes the rates, and a great deal of the traffic goes all rail. The Union Pacific and the Southern Pacific meet that competition with their joint line, but they could not compete with each other there.

Commissioner CLEMENTS. How do you dispose of the fact that prior to the control of the Southern Pacific by the Union Pacific there were separate and competing agencies and solicitation for freight in Chicago, Cincinnati, and many other cities in the Central West, soliciting it on the one hand to go over the Union Pacific and on the other hand to go over the Southern Pacific, and that those agencies have been since that time consolidated?

Mr. LOVETT. The Southern Pacific agency at Chicago, as the testimony shows, always worked for the Union Pacific-Central Pacific line. The agents worked for that line, because the Sunset line was an impracti-

cable route from that territory. The Southern Pacific, of course, wanted all the business it could get for that line because the Southern Pacific owned 850 miles of it.

In San Francisco the Denver & Rio Grande and all these transcontinental lines had their agents. The Southern Pacific had no preference as between the Denver & Rio Grande and the Union Pacific. It said, "Go out and get the business. If you can get it over your line from Ogden, it is immaterial to me. I will give it at Ogden to whoever gets it from the shipper. Take it at the rates we agree upon, as shown by our division, and if you can get it beyond Ogden I am not interested." Since then the Union Pacific, by this purchase, became the preferred connection of the Southern Pacific. There is no longer any necessity for its having any solicitor in the field at San Francisco, because whatever business shippers want sent all rail the Southern Pacific will turn over to the Union Pacific unless otherwise instructed by the shippers. The public is not interested in that. The Denver & Rio Grande people have been complaining some about it, but that amounts to nothing, because it is a matter of the selection of our connection, which we have the right to do under the law. The necessity for the separate agencies has been dispensed with in that way. There are other agencies that have been dispensed with, where there was some competition, and I will come to that in a moment.

The next situation to which I shall call your honors' attention is at Portland, Oreg.

It is true that the testimony shows that there was some competition between the Union Pacific System and the Southern Pacific at and in the vicinity of Portland. As I have already stated, Portland is the only common point of the two systems, except, of course, Ogden, where the two companies connect to form the transcontinental line. But our answer is that the competitive traffic at Portland, in volume and revenue, is so small as compared with the entire traffic of the two systems

that it is insignificant and legally unimportant. I have not had the figures prepared as yet, but from the opinion of those best informed I feel safe in saying that it would not amount to one-tenth of 1 per cent of the total. Without undertaking to recite the testimony, the facts developed are that the merchants of Portland who get goods from the Atlantic seaboard ship them as a rule by the short all-rail routes; that is, to the Missouri River, thence via the Union Pacific or via the Northern Pacific or Great Northern—the latter using the Union Pacific line from Spokane into Portland—but that sometimes they have sent goods via the Southern Pacific; that is, by steamers from New York to New Orleans and Galveston, thence via rail across Texas, New Mexico, and Arizona to Southern California, and northerly via San Francisco or Sacramento to Portland. The distance from New York to Portland via this route is about 5,000 miles and over several mountain ranges, whereas from New York to Portland by all rail is about 3,200 miles. The Portland merchants have testified that the Southern Pacific route was rarely used by them, because time and distance was against it. The Union Pacific always has been and still is the preferred route for this business.

The Portland merchants ship nothing east of the Missouri River; hence what I have just said disposes of any competition with respect to transcontinental traffic, so far as Portland is concerned.

It also appeared that prior to 1901 lumber manufactured at Portland and destined to Ogden and points in Utah and Colorado was sometimes shipped via the Southern Pacific as well as the Union Pacific. When moving by the Southern Pacific it was carried from Portland over the Siskiyou Mountains to Sacramento, Cal., and thence over the Sierra Nevada Mountains to Ogden, a distance of 1,400 miles; and when moving via the Union Pacific system it was carried by the O. R. & N. and Oregon Short Line over moderate grades to Ogden, a distance of about 850 miles. The volume of lumber thus moving over the Southern Pacific was very small. In 1901, after the Union Pacific

purchased the stock of the Southern Pacific and Mr. Stubbs was made traffic director of both systems, the Southern Pacific canceled its rates on lumber from Portland via Sacramento and Ogden to Utah and Colorado points, and all such lumber was required to move over the shorter and more direct route of the Union Pacific. But the rates were not increased, and all the shippers who testified said, what is obviously true, that the Union Pacific route of 850 miles was better than the Southern Pacific route of 1,400 miles, and the cost of transportation was necessarily much less, and that except during the extraordinary car shortage and consequent congestion of last autumn the service was much better than it had ever been via the Southern Pacific and Sacramento route.

It also appeared that the O. R. & N. Co. owned two or three small river steamboats which operated on the Willamette River between Portland and Salem, Oreg., and also owned two small steamers of 1,500 tons each which operated between Portland and San Francisco. It was claimed that the Willamette River steamers competed with the Southern Pacific line which runs near the Willamette River for the business between Portland and Salem, and that the Portland and San Francisco steamers competed with the rail line of the Southern Pacific from Portland across the Siskiyou Mountains to San Francisco. Ben. Campbell, now vice-president of the Great Northern Railway Company, in charge of traffic, who in 1901 and for many years theretofore was general freight agent and traffic manager of the O. R. & N. Co. and its boat lines, testified there never was any appreciable competition between the Willamette boats and the Southern Pacific, except perhaps for some local intrastate business between Portland and Salem and intermediate points; that the trading of that territory was with Portland and not San Francisco, and that such of the products of the Willamette Valley as moved to San Francisco were carried by the boat line to Portland and then transferred to the boat line for San Francisco, and the Southern Pacific never really attempted to meet the water rates

and carry such farm products over the mountains to San Francisco.

With respect to the O. R. & N. Co. boats between Portland and San Francisco, Mr. Campbell and others testified in substance that there never was any recognizable competition between such boats and the Southern Pacific rail line; that the cargo was almost wholly south bound, consisting of lumber and farm products, the latter coming chiefly from the O. R. & N. Co.'s rail lines in eastern Oregon and Washington, and there was more of this traffic than the boats could carry. Hence they seldom sought other south bound business, whereas north bound but little freight moved, and much of that was destined to points on the rail lines of the O. R. & N. Co., the boat line being run chiefly as an auxiliary of the rail lines of the O. R. & N. Co. During some seasons the boats did a good passenger business, but whether passengers went by rail or by boat always depended, of course, mostly, if not entirely, upon the question of time and the personal attitude of the passenger toward a sea voyage rather than upon any difference in rates.

Now, a word as to the oriental business.

The Union Pacific system in 1901—I do not recall whether it was before or after the purchase of the stock of the Southern Pacific—organized the Portland and Asiatic Steamship Company. That company was organized in 1901 under the laws of Oregon, with a capital of \$100,000, as I recall, and all its stock is owned by the O. R. & N. Co. Upon its organization it chartered three steamers, and since then it operated those steamers until the expiration of their charters, and has since operated other chartered steamers between Portland and Asiatic ports. By reference to a statement of its earnings and expenses for five years ending June 30, 1906, which will be found in the printed pamphlet of Exhibits, page 128, it will be seen that it has lost money every year since it was organized, except the year 1904-5, during the Russo-Japanese war, when it made \$63,000, and that the net loss for the five years ending June 30 last was \$283,000.

The original capital of the company has thus been more than exhausted and it is a mere paper concern, its stock being so worthless that I find the comptroller throws it out and does not include it in the statements of the assets of the O. R. & N. Co.

The question naturally arises why do the ships run when they are so consistently unprofitable? The answer is—solely for the protection of the grain traffic of the O. R. & N. Co.'s rail lines and that company's customers in Portland. There is a very rich grain territory in eastern Oregon and Washington reached by the rail lines of the O. R. & N. Co. and by the Northern Pacific. Most of the flour produced finds a market in the Orient. There are several steamship lines operating between Puget Sound ports and Asiatic ports and but one from Portland. If that line should be taken off, all the grain from the territory mentioned would move over the Northern Pacific to Puget Sound and then to the Orient, and the O. R. & N. Co. rail lines would lose the haul to Portland, and the flour mills at Portland and other points on the O. R. & N. would close. It is, therefore, to hold this traffic to the rail lines of the O. R. & N. and preserve the milling interest at Portland that the steamers are operated between Portland and the Orient. I assume that the profit on the rail haul is sufficient to recoup the loss on the steamers.

Before forming the Portland & Asiatic S. S. Co. to charter the steamers, the O. R. & N. Co. had made many experiments by contracts with shipowners who would undertake to put on steamers between Portland and the Asiatic ports but who successively found them unprofitable and retired from the business. There was the Doddwell Line, the Samuels Line, and an adventurer named Graham, who made some pretensions toward establishing a line, but none of them succeeded, and the responsible ones retired to avoid further losses.

I submit that a paper corporation owning no vessels and operating ships only under charter contracts and losing money on every trip was scarcely a factor for

consideration in such a transaction as the purchase by the Union Pacific of the stock of the Southern Pacific.

More than this, the Union Pacific was at that time and had been for many years before and still is the owner of one-half of the capital stock of the Oriental & Occidental Steamship Company, which operates ships between San Francisco and the Asiatic ports. It is apparent from all the circumstances that whatever business the Union Pacific handled between points east of the Missouri River, or even points on its own line and the Orient, it was manifestly to its interest for it to move via Ogden and San Francisco and the Oriental & Occidental Steamship Company rather than via Portland and the chartered steamers between Portland and Asiatic ports. At all events, it certainly was not to its interest to cut Asiatic rates via its Portland line when its interest in the Oriental & Occidental Company would suffer.

The testimony also shows that the Portland Steamship Line was never able to handle transcontinental business to or from Asia and for these quite obvious reasons: As a rule there was but one sailing a month, whereas from San Francisco there was a steamer every nine days. If the merchants in New York or Chicago had goods for Asia and shipped via Portland, it was, of course, subject to the usual chances of delay in rail transportation, and if the goods should arrive at Portland a day after the ship sailed, they would have to remain there for thirty days, whereas at San Francisco the delay at most would be only nine days. Of course no business man would hesitate about the selection of routes under these conditions. The same disadvantage operated on business from the Orient, because generally there would be instructions by shippers not to route that way, although the Portland boats did get a small percentage of the inbound traffic. The entire inbound traffic, however, including that for Portland and vicinity, was very small. Mr. Campbell testified that out of a total tonnage of the Portland Asiatic Line 90 per cent was outbound and only 10 per cent homebound.

There is only one other point, I believe, that I wish

to call attention to. That is the Clark road. Much importance seems to have been attached in this inquiry to the Clark or San Pedro line—sometimes called the Clark road. It is the road from Salt Lake to San Pedro. Much importance seems to be attached to that situation which I have not been able to appreciate.

The facts with respect to that matter, briefly stated, are that the Oregon Short Line R. R. Co. owned a line extending southwesterly from Salt Lake City to a point near the Utah-Nevada boundary line and a graded or partially constructed line extending farther and well into Nevada, when in 1902 Senator Clark, of Montana, who then owned the San Pedro-Los Angeles road, began preparations for the extension of it to Salt Lake. Both parties had surveyors in the field, and there was a race for the choice of location through canyons which the Oregon Short Line won; and a controversy over the possession of some unfinished grade was also decided in favor of the Oregon Short Line. Negotiations were taken up, and in July, 1902, a preliminary agreement was reached which was followed by the final agreements of June and July, 1903. By those agreements Mr. Harriman, acting for the Oregon Short Line, and Senator Clark agreed to establish a line of railroad between Salt Lake City and San Pedro; that a company to complete such lines should be formed, one-half of the stock of which should be owned by the Oregon Short Line and one-half by Senator Clark, and each to furnish one-half of the money necessary to complete the line; and the road of the Oregon Short Line south of Salt Lake City, including the unfinished grade, and the San Pedro-Los Angeles roads of Senator Clark, were sold to the joint company. The work of construction was commenced and diligently prosecuted to complete the link between Los Angeles and the Oregon Short Line extension. The money, amounting, as I recall, to something like \$20,000,000 in cash, was furnished, and the line was opened to business in May, 1905.

I can well understand how one company owning an existing line might be prohibited by law from

buying a parallel line. That is, at least, a debatable question. There is competition between such lines. For instance, I can understand why the Northern Pacific should be prohibited from buying the Great Northern, but I can not understand how there can be any restriction or suppression of competition by one company which owns an existing line building a parallel line.

So I submit the somewhat obvious proposition that there can not be any restriction of competition unless there is competition to be restricted, or, at least, unless there is a situation admitting of competition.

Now, the laws of many States prohibit one corporation owning a line of railroad from buying the stock or in any way controlling a corporation owning a competing line, but there are not many that prohibit the building of other lines. There is rather a widespread impression in this country now that a good many of the roads ought to have double tracks. If it is unlawful for a company owning one line to build a parallel line because, if separately owned, they might compete, the logical result of that argument would be that a company owning a single-track road ought not to build a double-track road because, having two tracks parallel, if they were owned by separate companies there might be competition between them.

The Union Pacific bought the stock of the Southern Pacific in 1901. If that purchase was lawful at the time it was effected, I can not quite see why the building of a competing line afterwards would render the purchase unlawful. If the Union Pacific to-day saw proper to build a line to the Pacific Ocean parallel with the Central Pacific, I take it that would not be unlawful; it would not be in restriction of competition, because there is only one line there now.

Commissioner LANE. Do you not regard the contract as vicious? I do not mean as to the extension of the Short Line's road southwest from Salt Lake City in connection with Clark, but the contract which they undertake for ninety-nine years to control the roads.

Mr. LOVETT. The traffic contract—I will discuss that in a moment. If your honors will permit me, I will pass it for a moment.

I will deal first with the purchase of the road. I do not think I have misunderstood counsel's contention in regard to this matter, that it is not merely the traffic contract, but it is the ownership of the Clark road that is involved. If there is no question to be raised as to the legality of that, of course I will not discuss it, but I have understood that the contention among others is that the Union Pacific, having this stock of the Southern Pacific, had now gotten another and competing line into southern California. My answer to that, without further enlarging upon it, is that we, with Senator Clark, built that line. There was no line there; there was no railroad, and we built it just as we might to-day build a line paralleling the Central Pacific from Ogden to the Pacific Ocean; and that there is nothing in the antitrust law to prohibit it, because it is not a suppression or restriction of competition. We had already acquired our interest in the stock of the Southern Pacific. It was not as if we had gone in and bought a constructed line after we had bought the Southern Pacific stock. That would present a different question. We built it just as we might build a parallel line with any other existing line.

Now, in reference to the traffic contract. I do not know a great deal about that, but the men who made it say that it applies only to local traffic in California. I take it that there is no local traffic as between the Southern Pacific and the Clark road except in Southern California. They do not serve the same territories except in Southern California. There is no local traffic between those roads except the traffic in California.

I understand perfectly well that in ordinary railway parlance "local traffic" means traffic taken up and put down on the same road. I take it that traffic between Los Angeles and Salt Lake City would be local traffic so far as the Clark road is concerned, but local traffic as between the Southern Pacific and the Clark road means

traffic local to both lines, to those competing lines within the State of California where they serve the same——

Commissioner LANE. It does not say that. It simply says "local traffic."

Mr. LOVETT. It says "local traffic which may be competitive," and the only competition between them is in California.

Commissioner LANE. Would not that be competitive between Salt Lake City and Los Angeles, or the Sacramento gateway?

Mr. LOVETT. Not at all. The Southern Pacific does not go to Salt Lake City. It goes to Ogden.

Commissioner LANE. To Ogden?

Mr. LOVETT. Yes. I have never assented to the proposition, and I never will, until the courts declare it, that railroads can be competing which connect only at one place and serve different territories.

Commissioner LANE. Yes; but they touch two points. Here is the Central Pacific, which touches Ogden and goes around Sacramento and down to Los Angeles.

Mr. LOVETT. No; the Clark road does not go to Ogden.

Commissioner LANE. It runs to Salt Lake City?

Mr. LOVETT. It runs to Salt Lake City.

Commissioner LANE. There is a difference of 36 miles——

Mr. LOVETT. Which, so far as that contract is concerned, fixes the definition of local traffic in the way that all the men who made it have testified, that is in California. As to whether they might compete from Salt Lake, it is not necessary to determine.

Commissioner LANE. Mr. Clark informs me that the Union Pacific has a line from Ogden to Salt Lake, which would bring them into direct connection.

Mr. LOVETT. Undoubtedly the Union Pacific has a line from Ogden to Salt Lake, but the Southern Pacific has not.

Commissioner LANE. But the Southern is controlled by the Union?

Mr. LOVETT. Yes; undoubtedly; and the Union Pacific has a large voice in the control of the Clark road.

But such, as I understand, is the position of our people in reference to the traffic contract.

It says "local traffic in competition between the Southern Pacific and the Clark road," and they say the only local traffic that was contemplated is traffic local in California, and that under the laws of California such contracts are legal. Of course it could be amended to confine it to California territory. That is what the men who made the contract and who are familiar with the situation testified, as I understand it. But I do know that the traffic between Salt Lake City and the Pacific coast, so far as the Southern Pacific is concerned, is not local traffic as to that line. It gets there through connection with the Union Pacific, just as it gets to the Atlantic seaboard.

Commissioner LANE. Is the ownership of the Clark road in the same condition to-day as it was when these hearings were had in Los Angeles?

Mr. LOVETT. Yes.

Commissioner LANE. There have been announcements in the newspapers that it was not. I did not know whether that was correct or not.

Mr. LOVETT. The report is absolutely without any foundation.

I believe there is one other point, that is as to the lines in Northern California that were formerly owned by the Southern Pacific and the Atchison and that were recently consolidated. But little need be said about that situation, as I view it.

The Southern Pacific owned two or three small roads up there. The Atchison had incorporated some companies that were building lines from the coast in the northern portion of California, southeasterly; and the Southern Pacific was building in the opposite direction—that is, building northwesterly. Their lines were separated by mountains. They had not gotten together anywhere, and the Atchison lines could scarcely be considered as operating railroad. The mileage was very small and they were widely separated from the Southern Pacific lines. As the result of negotiations that were commenced in 1905—early in 1905—they agreed

upon a basis for the consolidation of those lines. They consolidated, as authorized by the laws of California, the State by which all the corporations were created and where all the property is situated.

Our contention is that that is not a matter of any concern to any Federal authority; that California created these corporations; they had no lines extending across the borders of the State; that they were not competing, as they had not been constructed, and that California had the right to abrogate the corporate powers, so far as they existed under the charters, and with the consent of the owners, take away by consolidation the right to build more than one line, and that it was in the exercise of its power over those corporations, which it had created, that these consolidations were permitted; and although when completed the roads may engage in interstate commerce, they are not competing roads to-day, because they are not completed.

Construction through that territory is enormously expensive. I think that one of the connecting links will cost over \$100,000 a mile in cash, and it is going to require a very large outlay of money; but there is not traffic enough there for one road, much less two. It is an undeveloped country. So they have united their forces to develop that territory and build roads that in all these years and in these days of railway building have not been built because the undertaking was too great for the returns that were promised.

I must apologize to the Commission for the time I have taken. I had no intention of consuming so much time, and I regret very much that I have talked so long.

Commissioner CLEMENTS. We have been very glad to hear you, Mr. Lovett.

ARGUMENT OF MR. JOHN G. MILBURN.

Mr. MILBURN. May it please the Commissioners, I shall confine what I have to say to the purchase by the Union Pacific of the interest which it, or the Oregon Short Line, owns in the Southern Pacific. After listening to the very comprehensive and complete argument of Judge Lovett on the subject I would ordinarily be in-

clined to say nothing more, and there is really very little that I can add, but as this is a very important matter I am perhaps justified in making an additional argument, though it may involve some repetition.

I feel that the question before the Commission is one of the most important it has ever had to consider, and one more vitally affecting the railroad interests of the country than any that could be raised. If the ownership or control of the Southern Pacific by the Union Pacific be illegal because of any interference with competition, every important railroad system in the United States is illegal. The Union Pacific system with its control of the Southern Pacific is in that regard the least vulnerable of any of the great systems. The physical locations of the Union Pacific and Southern Pacific railroads are such that their union in a single system is a possible interference with competition in a very minor degree as compared with the conditions which other systems present. In the records of the Commission, consisting of the annual reports of railroad companies which have been put upon its files year in and year out, there is the evidence of great systems of railroads slowly built up through the years by the compacting together of lines between different points the competitive relations of which are and were apparent. Even trunk lines through extensive and populous regions of the country practically parallel with each other have been welded together into a single system by stock ownership, or in some other way. If that be an offense against the law, the Union Pacific in the control that it has acquired of the Southern Pacific is the most insignificant offender, and if you recommend proceedings against it you can not refrain from recommending proceedings against the others. This is a government of law, not of men, and a government of law is one which applies the law equally to all, and avoids all discrimination between persons or interests. To enforce the law against one and not against others in the same situation is, as Mr. Justice White said in the Northern Securities case, "repugnant to every principle of liberty and justice." It is because so many and such vast interests are

involved that I feel there is a great deal at stake in the matter before the Commission, and that a step is under consideration which calls for profound deliberation and slowly formed conclusions. It may therefore be serviceable to you to bring to your attention what I regard as the governing and controlling propositions of law and fact in the solution of the problem.

I propose to discuss the matter from the point of view of the law as it is. I know that the Commission can investigate with a view to recommending new legislation, but I am concerned with the legality of what has been done, and not with the enactment of new laws. I am satisfied if I can establish that what has been done is legal. If it be legal, whether there should be still more radical legislation, whether a new law can be drawn which will be more comprehensive in its scope and operations than the present law, I leave aside as a problem which I need not consider at this time.

Was the acquisition by the Union Pacific of its interest in the Southern Pacific a legal transaction? The only law which bears upon it is the act of 1890, entitled "An act to protect trade and commerce against unlawful restraints and monopolies," popularly known as the "Sherman act." That act makes illegal every contract, combination, or conspiracy in restraint of interstate or foreign trade or commerce. Broad as this language is, it has its limitations. The phrase "restraint of trade" has been treated by some courts and judges as the equivalent of the phrases "interference with competition" or "suppression of competition." I do not think it is, but whether it is or not I will not stop to discuss now, as I am willing to assume them to be equivalents, and to treat the act as denouncing every contract, combination, or conspiracy to interfere with or suppress competition. Mark, it is an interference with competition by a contract, combination, or conspiracy. For a transaction to be within the act there must be either a contract, a combination, or a conspiracy. Such a classification is far from coextensive with the business transactions of men which constitute interstate commerce and affect competition in one way or another.

There are many transactions which affect competition which are neither contracts, combinations, or conspiracies. There is very evidently a wide area of human conduct in the domain of interstate trade and commerce which the act does not touch at all. In enacting this law Congress was dealing only with certain kinds or classes of transactions in restraint of trade, and putting the ban of law upon them, and therefore all other acts, transactions, and relations are outside the pale of the act, however they may restrain trade or affect competition.

Is a purchase of property within the act? There is no appropriate phraseology to include acquisitions by purchase. It would have been very easy if it had been the intent of Congress to prohibit any acquisition of property by purchase which restrained trade to say so explicitly. The act would then have prohibited any contract, combination, conspiracy, or purchase of property in restraint of trade. That it fails to include acquisitions of property by purchase is of controlling significance because the right to acquire property is a fundamental right and one of the most potent factors in our civilization. I will never admit that this right to acquire property is seriously affected by legislation unless there is clear and explicit language in the law to that effect.

Commissioner CLARK. Would a contract for purchase and sale come within the limitation of the contracts inhibited by the act?

Mr. MILBURN. I think not, sir. If a purchase would not, I do not think a contract of purchase would.

Commissioner CLARK. Of course I have reference to a contract that by its effect restrained trade and eliminated competition.

Mr. MILBURN. Yes. I do not think that the term "contract," Mr. Commissioner, is an appropriate term to bring the acquisition of property by purchase, or a restraint of trade by the acquisition of property, within the act. In other words, if an act were being drawn to prescribe that competition should not be interfered with or suppressed by purchases of prop-

erty, it would be expressed in clear terms and not left to be inferred from such terms as "contract," "combination," or "conspiracy." Had the intention been to include purchases it would have been clearly revealed by the language used. But that could not have been the intention because, as you can see at a glance, if purchases of property which affect competition, even if they were made for that purpose, were prohibited, the business of the country would be seriously crippled. This act applies to all alike; it is not confined to railroad companies. Indeed, there was a grave question as to whether it applied to railroads at all, considering that their regulation was the object and purpose of the interstate commerce act, and that the effort to amend the bill before its passage to expressly include railroads was defeated. Though it has been applied to railroad companies by construction, the point I am making is that it is of universal application with respect to individuals and corporations, and reaches all individuals and all corporations. Just think of the effect of reading into it that any purchase of property which restrains trade or interferes with competition is illegal. A man buys a store of a competitor who sells his goods in various States; that restrains trade; is it, therefore, illegal under this act? Competitors in business form a copartnership or organize a corporation to which they transfer their plants and businesses—is that illegal under this act? But it is unnecessary to multiply illustrations. The indisputable fact is that a great mass of the transactions of business so far as the acquisition of property is concerned interfere with competition, and to prohibit them for that reason would derange, if not disrupt, the industrial and commercial system of the country. It is really not arguable that it was intended to extend the prohibitions of the act to the right to acquire property by purchase.

Let us now see to what transactions the act has been judicially applied.

An agreement between practically all of the railroads in an extensive region to maintain rates has been held by the Supreme Court to be an agreement prohib-

ited by the act, because in maintaining rates it interfered with the free play of competition. Hence it is settled that a combination of independent railroads to maintain rates is a combination in restraint of trade within the meaning of the act.

There next came under the consideration of the courts combinations of independent manufacturers engaged in interstate commerce to fix prices and regulate production by means of an agreement, or a selling company, or some other device, and they were held to be combinations in restraint of trade denounced by the act.

Then came the Northern Securities case, which involved the organization of a holding company by the stockholders of two great competing railway systems extending from the Lakes to the Pacific Ocean, the Northern Pacific and the Great Northern, to take over their shares in exchange for its own and thereby bring those systems under a single control. The Supreme Court held that this was a combination of shareholders of the two companies to suppress competition, and that the organization of the holding company was merely a device to accomplish that purpose. Treating the holding company as machinery to effectuate the scheme of the combination, the court held that the combination was the substantial matter and that it was in restraint of trade and therefore illegal.

This is the extent of the authorized interpretations and application of the act down to this time. They are obviously very far from bringing out-and-out purchases of property within the act though they affect competition. To bring them within the act will be a tremendous extension of its operation. We all know that during the last twenty years there has been going on in this country a process of amalgamating previously independent manufacturing concerns in many different industries through purchases and stock ownership. It has been the most marked feature in the industrial development of the country during that period. I am within bounds in saying that our existing industrial organization is largely the result of that process. In every instance there was a substitution of a single

concern for a number of previously independent and competitive concerns, and necessarily an interference with competition. In every instance there was a plan; there were negotiations; there were purchases. Does anyone maintain that they are illegal because of their interference with competition? But it is clear that these great industrial combinations depend for their legality upon the proposition that acquisitions of property by purchase are not within the act though they eliminate competition on a vast scale. To extend and expand it now to include them would be an incalculable shock to the industrial system of the country.

I have now stated my fundamental position. I have ventured to formulate a series of propositions which are in the main deductions from it, and the rest of my argument will be based upon them. They embody the results of my study of the act and the cases which have construed and applied it. I think it more appropriate and time saving to state my conclusions in that form than to attempt to analyze the cases separately and in detail, particularly as we are all so familiar with them.

These propositions are as follows:

(1) A restraint of trade to be within the act must be the direct, immediate, and necessary effect of the transaction, and not merely an indirect or incidental result.

(2) A restraint of trade consequent upon a *purchase* of property, in any of its various forms, is incidental merely and therefore not within the act.

(3) The purchase must of course be real; if a mere device for the suppression of competition, as it was held to be in the Northern Securities case, while it may be effective to operate upon the legal title as between the parties, it is in fact unsubstantial and may be disregarded.

(4) Provided the purchase be real and substantial the motive which induces it can not affect the result; for any resultant restraint of trade is still only consequential and incidental to the exercise of an absolute

and undoubted right—that is, the right to acquire property.

(5) Therefore the purchase by a railroad company, within its corporate powers, of an interest in another line of railway is not within the act, because the restraint upon trade, if any, is not direct, but merely incidental to the purchase.

(6) If, however, the purchase by a railroad company, within its corporate powers, of a line of railway be obnoxious to the act if made to suppress competition, that result does not follow if the purchase be made for a legitimate and proper purpose of the purchasing company.

(7) In any event a purchase by a railroad company of an interest in a line of railway which is not parallel and competing is not within the act.

(8) The purchase by the Union Pacific of its interest in the Southern Pacific was not made to suppress competition, but to protect its property by an extension of its line in that way to the Pacific coast.

(9) The Union Pacific and Southern Pacific are not parallel or competing lines or systems.

As I am addressing lawyers I need not say that the terms “direct” and “immediate” and “indirect,” “consequential” and “incidental” are terms of legal significance. There are distinctions in the use of them as legal terms which are not appreciated by the lay mind. But to lawyers it is enough to say that the underlying distinction between them is precisely the distinction which underlies the terms “proximate cause” and “remote cause” as legal terms. In other words, if a contract be made between two competing concerns to regulate prices, rates, or productions the effect of the transaction upon competition is in legal parlance immediate and direct. If a transaction respects the purchase of property its immediate and direct result is the acquisition of the property, and any results that flow from the ownership of the property are incidental or consequential. That illustrates the distinction between a direct and an indirect or consequential restraint of trade as I understand it.

I am very clear, for the reasons I have already given, that the Sherman Act was never intended to reach interference with competition in all the various kinds of interstate business resulting from the acquisition of property by purchase, even though the motive of the purchase was to absorb a competitor or to amalgamate two or more competitive plants or businesses. It has been suggested that the case of *Pearsall v. Northern Pacific Railroad* (161 U. S., 646) is adverse to that conclusion. That case involved an acquisition, or an attempted acquisition, by the Great Northern Railroad Company of an interest in the Northern Pacific Railroad Company, and it was held that the transaction was illegal because in violation of certain acts of the State of Minnesota to which both companies were subject. The Sherman Act was not involved at all and the case is not an authority with respect to the scope and operation of that act and does not in the slightest degree affect the proposition I have advanced. If the law of the State which created the Union Pacific Railroad Company prohibited it from making such a purchase as it made of the stock of the Southern Pacific, that would be the end of the matter. With such a law in existence the purchase would have been illegal because expressly prohibited by the State to which the company owed its being, but not because of any interference with competition; not because of the operation of the Sherman act. If there were in the laws of the State governing the Union Pacific or the laws of the State governing the Oregon Short Line limitations upon their powers far-reaching enough to prevent their acquiring an interest in the Southern Pacific, we would confront a very different question than any raised by the present record.

Prior to the purchase of its interest in the Southern Pacific the Union Pacific was dependent upon an entirely independent line west of Ogden to San Francisco. A legitimate railroad purpose therefore justified it in acquiring that line or the control of it. It bought that line—that is, it bought what was in effect the practical control of that line—for the purpose of oper-

ating it as part of its own system and bringing it under the policy of improvement and development pursued with respect to the entire system. Having that situation in mind, I insist, without further elaboration, that the purchase by the Union Pacific of its interest in the Southern Pacific was a real and substantial purchase within its corporate powers and for a corporate purpose, and nothing but a purchase. It was not a device or cover for anything else. A real and substantial need compelled the ownership or control of the Southern Pacific's line from Ogden to San Francisco; and the only way in which it could be acquired was to acquire a controlling interest in the stock of that company. It did acquire that interest for that purpose; and it is manifest that the transaction was an out and out purchase, and is to be judged as such. The situation is a very different one from that presented in the Northern Securities case. Here the Union Pacific, to control a through line to the Pacific coast and protect itself from the injurious consequences of the line from its western terminus at Ogden to San Francisco passing into the hands of adverse interests bought 45 per cent, or thereabout, of the stock of the Southern Pacific Railroad from the parties who owned it. That stock ownership gives it the practical control of a connecting railroad absolutely necessary to the integrity of its system. In the Northern Securities case it appeared, as the court construed the transaction, that certain interests owning stock of the Great Northern and of the Northern Pacific, two parallel and competing systems, organized a corporation which took their shares and held them, exchanging for them its own shares, and thereby through the new company those interests were enabled to control and operate these two parallel and competing systems in harmony. The new company was not in any sense a railroad company, but purely a holding company, and as such merely an instrumentality for the harmonious control of existing independent competing railway systems. There would seem to be no analogy between the two situations. The one was the vesting of control of independent systems in

a holding company; the other was a purchase of an interest in an existing railroad company by an existing railroad company for a legitimate and necessary corporate purpose of the latter. We stand firmly on the proposition that the acquisition by the Union Pacific of its interest in the Southern Pacific was a real purchase.

The Sherman act is not an act specifically pertaining to railroads; it does not put the transactions of railroad companies with each other in one class, the transactions of manufacturers with each other in another class, or the transactions of traders with each other in still another class; it does not differentiate transactions with respect to the persons who engage in them. It operates upon transactions regardless of who are the parties to them, and a purchase, therefore, by a railroad company having the power to make it stands on precisely the same footing so far as this act is concerned, and is to be judged by the same rules as a purchase by an individual or by any other kind of corporation. If a purchase by an individual or a manufacturing or business corporation be outside of the act notwithstanding it may interfere with competition, the purchase by the Union Pacific of its interest in the Southern Pacific is outside of it, notwithstanding it may interfere with competition, always provided, what is not disputed, that the purchase was within its corporate powers and not in conflict with the law of any State to which the two companies were subject.

But it may be argued that even if a purchase for a real and substantial purpose of the purchaser be not obnoxious to the act, though it involves an interference with competition, still a purchase the real or dominant motive of which is to suppress competition or to eliminate the conditions which competition has produced is within the act, I can see no basis for any such differentiation. The act is directed at transactions; not at motives. A contract, combination, or conspiracy which has as its subject-matter the control in some degree of rates, prices or production is condemned regardless of its motive. Reasoning by analogy, if a purchase of prop-

erty is not a transaction within the categories of the act it should not be brought within them because of its motive. And there are practical considerations which lead to the same conclusion. For instance, a number of businesses owned by different concerns may be acquired by one of them with mixed motives; such as the benefits of conducting the business on a large scale; the advantages of various distributing points; the greater command of capital; the elimination to some extent of competition. Is the validity of the transaction to depend on the comparative weight of these different motives; and, if so, how is it to be ascertained? An ordinary effect of large classes of purchases is an interference with competition, and to make their validity depend upon whether that was their motive or not imparts an uncertainty into transactions which would seriously menace and disturb industrial conditions. It is quite clear to me that this act was never intended to raise such questions. It was never intended to regulate or affect the acquisition of property by purchase, whatever may be the motive of an exercise of the right. There has been so far no interpretation of the act imputing to it any such intention, and in the absence of such an interpretation I feel justified in standing upon the proposition as I have formulated it.

But if this proposition be modified to read that purchases for a real and legitimate purpose are outside the act, and purchases for the purpose of controlling or suppressing competition are within it, I insist that the purchase by the Union Pacific of the interest in the Southern Pacific which it owns was a purchase for a legitimate purpose and not to control or suppress competition. I submit that there is no evidence in this record which would for one moment warrant a finding that the motive or purpose of that purchase was to control or suppress competition, or to remove obnoxious conditions created by competition. I do not recall any evidence that it has given to the Union Pacific any more practical power over transcontinental rates than it had before, or tending to show that it was acquired with

any reference to the power of rate making or to any other competitive condition. There is nothing in the record which would justify a finding that the purpose and intent of the transaction was any other than to acquire control of the line from Ogden to San Francisco for the purpose of extending the Union Pacific system to that point—an extension absolutely and vitally necessary to its efficiency and prosperity. I say, therefore, that this was a proper purchase; that it was a purchase for a legitimate purpose of the Union Pacific; that it was not a purchase, scheme, or device made or entered into to control or suppress competition or restrain trade; and that any interference with competition which has resulted from it is trivial in volume and was not the motive, cause, or purpose of the transaction.

We have now reached the point that this transaction is not within the act if it was a purchase, nor is it within the act even if a purchase made to suppress competition is condemned by the act because it was not a purchase made for that purpose.

Commissioner LANE. Mr. Milburn, the acquisition of the Southern Pacific stock was made about the same time as the purchase of the Northern Pacific stock, and it was expected by Mr. Harriman undoubtedly that he would be able to control through the Union Pacific the Southern Pacific and the Northern Pacific. Might that not go to the purpose for which the purchase of the Southern Pacific stock was made?

Mr. MILBURN. I do not see, Mr. Commissioner, any basis in the evidence for that inference or for tying together the two transactions. It clearly appears that they were separate and independent transactions and that each had its separate and independent motive. The unquestionable motive for the purchase of the Southern Pacific was the control of the line from Ogden to San Francisco as a necessary adjunct to the Union Pacific system. There has been no inquiry in this investigation into the reason for the acquisition of the Northern Pacific stock. Only the bare fact has been brought out that it was acquired and later disposed of.

Judge LOVETT. Mr. Milburn, if you will allow me a suggestion there——

Mr. MILBURN. Yes.

Judge LOVETT. The negotiations for the purchase of the Southern Pacific were pending before the death of Mr. Huntington, which occurred in the year 1900. Negotiations had been pending for the purchase of the Southern Pacific long before there was any thought of acquiring an interest in the Northern Pacific.

Commissioner LANE. As I remember the testimony, it was that the issuance of the 100 million dollars of convertible bonds was for the purpose primarily of acquiring the Southern Pacific and Northern Pacific.

Mr. MILBURN. Forty millions of dollars for the Southern Pacific.

Mr. KELLOGG. Sixty millions for the Northern Pacific and 40 millions for the Southern Pacific.

Mr. MILBURN. That is how the proceeds of the bonds were used. As Judge Lovett says, the negotiations for the purchase of the Union Pacific had been pending for a long time and were consummated in the beginning of 1901. The purchase was financed through this issue of convertible bonds, of which 40 millions of dollars were used for that purpose. Later 60 millions of dollars of the issue were used for the purchase of the Northern Pacific stock. That the proceeds of the same issue of bonds were used in making these purchases is no evidence that both interests were to be acquired pursuant to a scheme to control competition. The transactions were separate and independent; there was no combination or conspiracy; the purchases were made by or on behalf of the Union Pacific in the open market in the ordinary course of business; and the record reveals a separate, independent, and real reason for the purchase of the Southern Pacific interest and one entirely disconnected with the purchase of the Northern Pacific stock. I can not see any evidence on which the Commission can predicate any other finding. The Southern Pacific purchase stands on its own reasons and is justified by its own facts, and it would be unjustifiable to affect it now

by the hypothesis of a vast scheme or dream which has not materialized.

Commissioner LANE. Well, you judge the purpose by what was done?

Mr. MILBURN. Yes, sir.

Commissioner LANE. And at the same time that the Southern Pacific was acquired—that is, not only the Southern Pacific leading from Ogden to San Francisco, but the Southern Pacific leading from New Orleans to San Francisco and Portland—the Union Pacific also attempted to get possession of the Northern Pacific from the Lakes to Portland and Puget Sound. Is it not, then, reasonable to infer that the purpose of the Union Pacific was to get hold of these three parallel lines leading to the Pacific coast? Is not that just as reasonable an inference from the testimony we have as the inference you make that the primary purpose was to get a line westward from Ogden to San Francisco and that they only took the Southern Pacific leading from San Francisco around to New Orleans as incidental to the main line leading westward from Ogden?

Mr. MILBURN. In the first place, it was not optional with them to take one part of the Southern Pacific and not another. They had to buy the whole to get the part. In the next place, it needs no argument to show that the line from Ogden to San Francisco was indispensable to the Union Pacific and that no body of prudent men managing the Union Pacific system would leave that line to the Pacific coast unacquired, particularly as it might at any time fall into adverse hands. So much is plain and clear that the men in charge of the Union Pacific, realizing the age of Mr. Huntington and that his holdings in the Southern Pacific might at any time pass into other hands, deemed it necessary, in the interest of the property in their charge, to purchase a controlling interest in that road and secure the line to San Francisco. This was determined upon long before the purchase of the Northern Pacific stock was mooted, and what I contend is that any finding on this subject should be based on the

real facts of the situation and not on the assumption that it was part of a scheme or dream to control a group of transcontinental lines which I believe an inquiry into the facts would show never existed.

Commissioner LANE. Well, that dream would not originate if that finding were made by the Commission in the minds of the Commission. It originated in the mind of Mr. Harriman when he bought the Northern Pacific and failed because he found that the preferred stock did not give him control.

Mr. MILBURN. No; what I am saying is that there is nothing before you to connect the purpose in negotiating with Mr. Huntington for the Southern Pacific stock in 1900 and in acquiring that system with any purpose or intention he may have had long after with respect to the Northern Pacific. I am not concerned with what his purpose was in purchasing the Northern Pacific stock in 1901, because that question is not here, no inquiry having been made with respect to it. What I am concerned with is the situation when the Southern Pacific stock was acquired, and what the purpose was in acquiring it, and I insist that the plain purpose and intent was to secure for the Union Pacific a line from Ogden to San Francisco which it could control as against any adverse interest. That is my deliberate view of the matter, and it is to be borne in mind that the purpose or intent is important only if a purchase with an intent to affect competition is by reason of such intent invalidated by the Sherman Act, a view of the act which is in my judgment utterly untenable.

I now come to another proposition, which is that the Union Pacific and Southern Pacific are not parallel and competing, or competing, systems of railway within any reasonable definition of what constitutes competing railway systems that can be framed.

I draw one line in my mind from Council Bluffs, Omaha, or Kansas City to Ogden, and thence running northwesterly to Portland. I draw another from Portland, through San Francisco and Los Angeles to New Orleans, and thence by water to New York. I say that

those two lines are not competing lines within any meaning that has ever been attributed to those terms or that ever will be attributed to them. Compare with them the Great Northern and Northern Pacific systems extending along parallel lines from the Great Lakes to the Pacific coast in such close proximity to each other that they particularly drain the same regions. The contrast is so apparent and so radical that so far as competitive conditions are concerned there is no identity or analogy between the relations of the Union Pacific to the Southern Pacific and the relations of the Great Northern to the Northern Pacific. The Great Northern and Northern Pacific are clearly in the category of competing lines; the Union Pacific and Southern Pacific are not, unless all railroads are deemed to be competitive regardless of their geographical location.

We are now evidently reaching the time when an authoritative definition of what are competing railway lines will have to be formulated. There is at present little light on the subject to be obtained from authority. Experience is more fertile in its suggestions. For over fifty years railroads have been consolidating with each other and leasing each other's lines under the authority of legislation, and the only limitation on the process that has developed is that parallel lines shall not be consolidated or otherwise united. The suggestion of its legislation and experience is that the competition which the law has safeguarded is the competition between parallel lines, and that railroads are only competitive in the eye of the law when they are parallel. Applying this test, the Union Pacific and Southern Pacific lines or systems can not be designated as parallel lines or systems with any regard to the real meaning of the term. Parallel lines are lines that run side by side, north and south, or east and west, sufficiently near to each other to drain or serve the same territory. They are not parallel lines if they are too remote from each other to do so, or if they run in distinctly different directions. In no sense is a railroad running from Portland to Ogden, and thence to Omaha, parallel with a railroad running from Portland to San Francisco, and thence to

New Orleans. Hence, if competing railroads are, as a matter of legal definition, substantially parallel railroads the Union Pacific and Southern Pacific are clearly not in that category.

But to broaden the discussion somewhat I submit that railroads are only competitive as to any traffic when they can take it at the point where it originates and put it on their roads. The railroads with terminals at New York and Jersey City are competitors for westbound traffic originating at the port of New York because they can take it at those points, issue bills of lading for it, and put it onto their roads there. If this be the true view the Union Pacific and Southern Pacific are not competitors excepting with respect to transcontinental eastbound traffic originating at Portland, and as Judge Lovett has shown that is an infinitesimal quantity by reason of the fact that the Southern Pacific's route from Portland over two mountain ranges to San Francisco, thence to New Orleans, and thence by water to New York is impracticable as compared with the Union Pacific's route from Portland to Ogden and thence east. Starting at Omaha, Council Bluffs, or Kansas City the Union Pacific is not a competitive line with the Southern Pacific for westbound traffic, whether we regard the latter as starting at New York with its steamship line or at New Orleans with its railroad, for the reason that the traffic over the former so far as it is concerned originates at Omaha, Council Bluffs, or Kansas City, whereas the traffic over the Southern Pacific originates so far as it is concerned either at New York or New Orleans. They have no common point where they each take westbound freight onto their roads or lines, and no such point within a thousand miles of each other. Can it reasonably be argued that they are competitive lines because the same freight may on its way from east to west, or west to east, go over either line or some portion of it? Are they competitive lines because freight originating in New York destined for San Francisco or the Orient may go by the Southern Pacific, by sea to Galveston or New Orleans, and thence by railroad to San Francisco,

or by an all-rail transcontinental line of which the Union Pacific from Omaha to Ogden is simply one link? Are they competitive lines with respect to such freight when the first contact of the Union Pacific with it is at Omaha, more than 1,500 miles from the point of origin where the Southern Pacific would take it? If so, then every railroad in the United States is competitive with every other railroad because it is inconceivable that some freight might not, taking one route pass over one of them or part of it, or taking another route pass over the other or part of it. I do not think that such conditions determine whether railroads are competitive or not.

But assuming for a moment that the Union Pacific and Southern Pacific might be deemed under ordinary conditions to be competitive with respect to transcontinental traffic, because one with its ships and railroad is a through transcontinental line, and the other is a link in various lines from the Atlantic seaboard to San Francisco, they can not be so regarded in view of the fact that the Southern Pacific with its line from Ogden to San Francisco is also a link in the same through lines of which the Union Pacific is a link. No such through line could be made without the consent of the Southern Pacific; no through rate could exist without its participation; and in every such line it would, because of its position, be not only an essential but a dominating element. How could a line made up, say of the New York Central, Lake Shore, Chicago, Burlington & Quincy, the Union Pacific and the Southern Pacific be really competitive with the Southern Pacific's through route via New Orleans or Galveston when the existence of the former as a through line with through rates is dependent upon the cooperation of the Southern Pacific by reason of its ownership of the railroad from Ogden to San Francisco? The acquisition of the Southern Pacific by the Union Pacific makes those lines no more and no less competitive than they were before. The possibilities of competition are just the same between any such line and the through line of the Southern Pacific whether they continue separate

companies or either owns the other. From no point of view can I regard the Southern Pacific and the Union Pacific as competitive systems.

I have now, though very imperfectly, covered the question of the bearing of the Sherman Act on the validity of the acquisition by the Union Pacific of the interest in the Southern Pacific, which it owns. Much more could be said, and indeed all I have attempted to do is to outline what I may call our fundamental positions. I feel that this is a matter deserving of most serious consideration at your hands. The purchase was made in 1901, and it has been a matter of record in the annual reports filed with the Commission ever since. These two systems have been ever since operated as a unit. They have been developed into one of the great railroad systems of the country, and securities to a very large amount have been issued and marketed on the faith of that unity as an existing and permanent fact. More than 250 millions of dollars have been spent on their improvement and development. I could ask nothing better than that you have your statistician compile from the reports of the entire system the data which would show what has been accomplished for the public convenience and good during the last seven or eight years, and compare the results with those of any other system in that vast region of our country.

Commissioner CLEMENTS. Mr. Milburn, is it your contention that no matter what may be the effect of a transaction of this kind with regard to restraint of trade or competition that it is without the provisions of this act if its intent is something other than to restrain trade?

Mr. MILBURN. Yes; my position is that as it was a real purchase any restraint of trade is incidental and immaterial.

Commissioner CLEMENTS. No matter what the effect is and no matter what the motive is?

Mr. MILBURN. Yes, sir; just as if one manufacturing concern bought the plants of four or five others in competition with it to extend its own business and be relieved from that competition.

Commissioner CLEMENTS. If you buy them with intent to suppress competition and if it does suppress competition and does create a monopoly——

Mr. MILBURN. That goes a little further, sir.

Commissioner CLEMENTS. Well, that is a part of this act.

Mr. MILBURN. I know.

Commissioner CLEMENTS. I am just asking to see where your conclusion would go.

Mr. MILBURN. But there is a difference between restraint of trade and monopoly. I have not been discussing the subject from the point of view of monopoly. I do not see any question of monopoly here.

Commissioner CLEMENTS. Well, your idea then is that no matter how plainly the intent is to restrain trade, no matter how effectually it does restrain trade, if it is done through a purchase it is not illegal.

Mr. MILBURN. That is my contention. I will put it in this way. There has been no interpretation as yet of the Sherman Act which makes a purchase with that intent illegal, and if there ever should be such an interpretation I would like to know what will become of the industrial organizations of this country. We all know about them and that every one of them had that as one of its purposes. Perhaps the main purpose of most of them was to amalgamate the concerns acquired to get rid of competition. If that be ever held by the Supreme Court to be in violation of the Sherman Act there will be a nice tumbling down of things. I don't believe it will ever hold any such doctrine.

Commissioner CLEMENTS. If you have in view what appears to be the purpose of that act, to maintain freedom of trade, and to that end prevent restraint and suppression of competition, what difference does it make to the public how it is effected? Isn't the effect the only test of the validity of the transaction?

Mr. MILBURN. Well, Mr. Commissioner, the view I take is this: Business exists by reason of various activities and conditions. Competition is one form of activity. The acquisition of property is another. The

acquisition of property is a constant interference with competition. We can not have unrestrained and unlimited competition unless the right of acquisition is cut down to a degree that will destroy or at any rate seriously impair our industrial and commercial system. There are two men in a village each running a forge. There is not enough business for both, and both are doing badly. One buys the other out and then asks a little more for his work and gets along. That is a purchase; it suppresses competition; and that suppression is the purpose of it. Is the transaction illegal because in restraint of trade? Unlimited competition can not coexist with the right of acquisition by purchase. To fix the extent to which the right to buy property should be restricted in the interest of competition would be a very difficult piece of legislation. My view is that the Sherman Act did not attempt to solve that problem. It did not meddle with the right to buy and acquire property. It was satisfied to reach out and condemn contracts, combinations, and conspiracies to restrict production, to fix prices, and to suppress competition in other directions. That was a great deal to do and about as much as could be accomplished. It did not seek to legislate us either into the millenium or chaos.

Commissioner CLEMENTS. It says "in restraint of trade," not "made with intent to restrain trade."

Mr. MILBURN. I do not think it makes any difference whether there is or is not actual restraint if a contract, combination, or conspiracy is one which regulates, fixes, or maintains rates, prices, or production. That is what was held in the Trans-Missouri Freight Association Case (166 U. S., p. 290).

Commissioner CLEMENTS. The effect there was to place the power in the association to restrain trade.

Commissioner HARLAN. I was just going to say your doctrine applied to the Northern Pacific case means this: That if the same interests that effected the organization in the Northern Securities case had effected the purchase of the Northern Pacific by the Great

Northern it would not have been within this act, though the same results would have been accomplished so far as restrictions of competition are concerned.

Mr. MILBURN. Judge Brewer said in the Northern Securities case that if an individual had resources enough to buy the control of both roads there was no law to prevent him doing so. He could do so in the exercise of his right to buy and acquire property, and the effect upon competition would cut no figure at all. That power therefore exists consistently with what was held in the Northern Securities case.

Commissioner CLEMENTS. If one of these transcontinental lines—for instance, the Union Pacific—should effect various reorganizations and purchases of stock, and acquire the means by which to do it by bonds or otherwise, and get control of the majority of the stock of each of these transcontinental lines, would it not be offensive to this law?

Mr. MILBURN. It would not offend the Sherman Act for the Union Pacific to purchase the stock of any railroad company which it is authorized by its charter to purchase and which is not prohibited by the law of any State binding upon it and the company whose stock it proposed to acquire. The prohibitions of State laws must not be overlooked. I have already referred to the Pearsall case, which held the attempted acquisition of an interest in the Northern Pacific by the Great Northern to be contrary to the laws of the State of Minnesota. Probably any such sweeping scheme as is indicated in the inquiry of the Commissioner would find itself blocked by State laws. Moreover, the question is what the present Sherman Act prohibits, not what should be prohibited. I have argued that it does not extend to acquisitions of property by purchase, and that whatever may be accomplished through the exercise of that power is unassailable so far as that act is concerned. Whether the act should be extended to cover purchases is a political, not a legal, question. There is a widespread feeling that it is already too radical in its provisions. But whether it should be extended or limited in its

scope is a question of policy which concerns the future and does not affect what has been done.

I can not close without repeating what I said in opening. I notice from the language of the resolution under which this investigation has proceeded that it directs an inquiry into the whole subject of the effect of the control of railroads by other railroads through stock, ownership, community of interest, or otherwise. I feel very strongly that the Union Pacific should not be singled out for exclusive consideration. I submit that your inquiry and report should cover the whole subject. The Pennsylvania system, the Vanderbilt system, the Northern Pacific system, the Rock Island system, the Great Northern system, are all made up by consolidations, acquisitions, and control in various forms of competing lines. That is a process that has been going on for years and years. It was going on when the interstate-commerce act and the Sherman Act were enacted; it has been going on under the eyes of this Commission ever since. The growth of these systems has been known of all men; it has been recorded year by year in the files of this Commission. If there is to be now inaugurated a policy of dismemberment let it be a policy affecting all concerned, and not a single interest. I do not believe at all in a policy of dismemberment, in a policy of disruption. These great systems have been and are a great public benefit; they have many points in their favor if they have some disadvantages. They are the only means by which the vast sums of money can be raised that are necessary to keep the railroads of the country at all adequate to the needs of the people. There is an enormous demand for railroad expansion and improvement in every direction; it is a demand that is constantly increasing; and small roads and small systems can not secure the capital necessary to meet it. The larger these systems are the greater the efficiency of their service and facilities if they are well managed and operated. A few great systems furnish a much more prompt, adequate, and economical railway service than a mass of little inde-

pendent roads or systems, half of them in financial trouble, and all of them hampered and crippled in securing the means to grow with the growth and development of the country. I see no more occasion for alarm in the mere size of railway systems than in the size of the United States itself, of which we are so boastful. The people of a country so big, so rich, so unlimited in its resources, so rapid in the growth of its wealth and population, need not be afraid of the size of its industrial or transportation agencies, with governmental regulation and control ever present and active. I am addressing a body which is invested with the power to fix reasonable rates for railway service, to make through rates and joint rates, to prevent discriminations, to prevent rebates and concessions of every kind, and not only to search every nook and corner of every railroad office in the United States to find out whether the law is being observed, but to order at any time the officials of any and every railroad before it to render an account of their stewardship. If the politicians will only let the railroads alone for a few years and allow this Commission to exercise in calmness its great powers, I have no doubt that most of the problems now agitating the public mind will be worked out and solved. Armed with such powers as you have there is nothing to be feared from the organization of the railroads of the country into great systems, and much to be gained from what they are able to accomplish for the public good. I ask the Commission, in the exercise of its important functions, to go slow in the disruption of the existing railway systems. And I ask the Commission, in the interest of fair play and justice, if it is going to embark on a policy of disruption, not to select any particular system for attack but to treat all alike, and with that final request I close and thank you for your attention.

Commissioner LANE. Mr. Milburn, before you sit down, let me draw your attention to the fact that Mr. Harriman, in his testimony, said that were it not for the restraint of the law he would have taken, or he would take to-morrow, the Santa Fe, and he evinced a

desire to get the Northern Pacific. Now, supposing he had the Southern Pacific, and the Santa Fe, the Union Pacific, the Central Pacific, the Northern Pacific, and the control of the Illinois Central, if you please, he would have control of all the lines leading into Oregon and California and the main Pacific coast ports, excepting Puget Sound. Now, he acknowledges it was the restraint of the law that kept him from effecting that purpose.

Mr. MILBURN. Mr. Commissioner, I do not think you should lay too much stress on a sweeping remark of that kind made by a witness. Mr. Harriman was not referring to an actual programme; he was expressing an ideal that he has in his mind which I personally do not think can ever be carried out except through governmental ownership—from which God save us. That ideal is that if all these roads were operated in harmony they could be improved as they should be improved, the traffic could be distributed as it should be distributed, one road could be used for one kind of traffic to which it is adapted and another road for another kind of traffic to which it is adapted, rolling stock would be moved over all the roads without delay, obstruction, and detention, and generally transportation under these conditions would be more efficient, more rapid, and less costly. It was, I repeat, the expression of an ideal and not of an actual undertaking in the carrying out of which he was thwarted by the law.

Commissioner LANE. Now, you made a very impassioned and impressive appeal to the Commission, an appeal to the Government, not to go too far. I want to direct your attention to the fact that it is only by going as far as the Government has that certain people have been kept from going farther than they have.

Mr. MILBURN. I suppose you mean by that the Northern Securities case.

Commissioner LANE. I mean that the policy of acquisition has not been carried as far as it might have been carried, because it was "Hands on" instead of "Hands off;" because the law did exercise its restraining power. Your appeal is that the Government shall keep its

hands off. I am familiar with the economic principle, but isn't it one that can be carried too far?

Mr. MILBURN. I have not intended to argue that any backward steps should be taken. I am opposing dismemberment along new lines and on forced and strained constructions of the existing law. The Northern Securities case has prevented combinations of the kind there involved. The law of that case is loyally accepted. What I am objecting to is another and more radical interpretation. The existing railway systems are not in my judgment within the rule or principle of that case. There are eight or nine of them that have been compacted by consolidations, by leases, and by stock ownership. I do not believe in the dismemberment of those systems, because they have been, as I believe, legally put together, and the law should not be strained to make them illegal. They have grown up, they have been recognized by the Government, they have been sanctioned, as it were, by all these years and years of acquiescence.

Commissioner LANE. Do you not think, even if those were contrary to law, that there might be a statute of limitations that would run in their favor, and that combinations of that kind that had existed for many years and been recognized before the sentiment of which Mr. Cravath spoke was developed should continue as they are?

Mr. MILBURN. I would say, as President Lincoln said of the statute of limitations in politics, that it should be a very short one.

Mr. SEVERANCE. You have six years; make it less than six years.

Mr. MILBURN. We have six years behind us, so I will stipulate for a statute of six years.

ARGUMENT OF C. A. SEVERANCE.

May it please the Commissioners, I want to submit a few observations upon this record and upon the legal positions that have been assumed by the learned gentleman who preceded me.

I think if the argument is reduced to its ultimate it will be found that two propositions are advanced:

First, that the Sherman law, so called, is inapplicable to such a situation as is presented here, by reason of the fact that the acquisition of the control of the Southern Pacific by the Union Pacific is by way of purchase, rather than through such a combination as was evidenced in the Trans-Missouri case or in the Northern Securities case.

And, secondly, that even if the law be construed so as to prohibit the acquisition of this control by purchase, that the lines were not competitive within the meaning of the law and therefore not within the scope of the act.

I am unable to agree with my friends upon either of these propositions. Upon the first, which Mr. Milburn has referred to as his fundamental proposition, namely, that the Sherman law should not be, would not be, and can not be construed to prevent the purchase of a competitive railroad by another road, he has strangely overlooked the fact that the specific question which he is arguing here has already been presented and decided by the Supreme Court of the United States, in a case in which his client, Mr. Harriman, and the Oregon Short Line were parties.

That the purpose of the Sherman law was to prevent railroad combinations does not seem to be seriously disputed. It can not be controverted, in view of the decision in the Trans-Missouri case, which has been affirmed every time the court has had occasion to mention it.

The Commission will recall that in that case it was urged very strongly by the representatives of the railroads that the interstate commerce act alone was intended to be applied to the railroads and that the Sherman Act, so-called, had no application. But the Supreme Court overruled that contention and broke up the freight association which was questioned in that case. That ruling was affirmed in the Joint Traffic case, and it was specifically affirmed not only in the majority

opinion of Mr. Justice Harlan in the Northern Securities case, but in the dissenting opinion of Mr. Justice Holmes, in which he stated that he fully adhered to and gave credit to the ruling there laid down.

So it can not be disputed that the Sherman Act is applicable to railroads, if a proper case is presented, under the act.

In the second place, it is not essential, as seems to be assumed by my friends, that a road should be parallel as well as competing. If you will examine the constitutions and statutes of the States which deal with the question of the amalgamation of parallel or competing roads, you will find that in almost every instance the words are used in the alternative. They are "parallel or competing," not "parallel and competing." The construction of those constitutions and those statutes have all been in that way. That is to say, it is the evil aimed at which the courts consider and not the question whether the two lines may lie side by side or one of them may go around. They must be parallel or competing, not necessarily parallel and competing.

That was decided in the case of the State *v. Vanderbilt* (37 Ohio State, p. 590), and that case was cited with approval, and a considerable quotation was made from it in the case of the Louisville & Nashville against Kentucky in 161 U. S., at page 677.

The facts in that case were these: Two lines of railroad, the Cincinnati, Hamilton, and Dayton and another, started from Cincinnati and moved north. One of them ran to Cleveland and the other ran to Toledo; but by virtue of the fact that they both reached Lake Erie, the rates between these lines and their connections were so adjusted that freight would move over either line to various points in the West and to the Atlantic seaboard, for the same rate. They were held to be competitive lines, and of course there can be no question that that was the correct ruling.

Again, in a case which arose in the imperial State of Texas, from which my friend Judge Lovett comes, the same ruling was applied in the case of the East Line and Red River *v. The State*, reported in 12 Southwestern

Reporter, page 690. The court decided that two roads not parallel and not competing except through their connections were within the prohibition of such a constitutional provision. The court adopted the findings of the lower court, one of which was as follows:

“Disregarding their connections with other railroads and lines of transportation, The East Line and Red River and the Missouri, Kansas & Texas railroads were not competing roads when said sale was made. Considered with reference to such connections, they were competing roads.”

And the Supreme Court said:

“We further concur with the court below in holding that railways by reason of their relations, control, or management of other lines than their own, may become, within the meaning of the law, competing lines, though the railroads owned by them may not in fact connect.”

So I think we may regard the proposition as established, and it is common sense that it is immaterial whether the railroads, which were or are competitors of each other by reason of their relations with other lines which bring them traffic, are parallel or not.

It is an immaterial circumstance here that the Union Pacific goes directly west from the Missouri River, and the Southern Pacific goes from New Orleans around to Portland by the route that it does take, if by reason of their connections and the traffic that comes to those lines they are naturally and actually competitive lines.

Counsel read to the Commission on yesterday certain Federal statutes relating to the Union Pacific and the Central Pacific lines, but they do not aid his contention. In the first place, between the time that those statutes were passed and the time the Southern Pacific stock was purchased by the Union Pacific, the Sherman law had intervened.

Under the rule specifically laid down in the case of *Pearsall against the Great Northern* (161 U. S., at p. 646), it was held that any right to do those things which would have constituted a monopoly and which would have been in restraint of trade, which had been granted originally and had not been exercised, could be taken away and the law could interfere.

But further than that, there is a much better reason why those statutes do not aid his contention, lying in the fact that the statutes themselves command these roads to be operated as continuous lines under penalties.

Again, Mr. Milburn's argument is largely and, in fact, almost wholly based upon the proposition that the Sherman law has no application where the consolidation or acquisition or control, whatever it may be, is brought about by means of a purchase. He stated over and over again, and repeated it in answer to questions by the Commissioners in his desire to have them understand his position, that that was his view and that by reason of that fundamental proposition, as he put it, this purchase was legal, although it did, in fact, suppress competition and although it might have been made for the purpose of suppressing competition.

In the Northern Securities case, in 193 U. S., it was argued by counsel that there was no purpose to restrain competition—that is, that the purposes of the incorporators of the Northern Securities were laudable, and that they intended to maintain and to extend great oriental commerce; that it was necessary to secure possession of the Northern Pacific road in order to prevent it from falling into the hands of a line to the south, namely, the Union Pacific; that the boards of directors had been maintained in their integrity; that there had been no stifling of competition; that the Northern Pacific had its own board and its own officers, and that the Great Northern had its own board and its own officers.

It was further urged there that only from 3 to 4 per cent of the traffic of these two systems was competitive traffic. You will find that urged in the brief and testified to in the record.

In spite of all these facts, in spite of these protestations made by the gentlemen who incorporated this company to the effect that they were actuated by the highest motives, in spite of the fact that only a small percentage of the traffic was strictly competitive traffic, the Supreme Court of the United States held that the incorporation of the Northern Securities Company and

the transfer to it of the stocks of these lines which were competing lines, although only for a short distance parallel within the sense that the word has been used here by my friend, was illegal under the Sherman Act.

But counsel say that the Northern Securities Company case differs from this case by reason of the fact that it was not a purchase of one line by another line, but was the organization of a third corporation, which took over the stocks of the two companies. Some expressions of Mr. Justice Harlan, in the majority opinion in that case, are cited as holding that view.

After the Northern Securities decision was handed down the gentlemen in control of that company proceeded to redistribute the stocks they had acquired. As you know, nearly all of the stock of the Northern Pacific and Great Northern companies had been acquired by the Northern Securities Company. Under the decree entered by the circuit court for the district of Minnesota in that case there was a prohibition against the stock so owned by the Northern Securities Company receiving any dividends or being voted or exercising any control whatever over the affairs of either of the corporations. Consequently it was worthless stock. It was essential to wind up the securities company in some way and distribute the stock which it held.

The directors of that company decided that they would distribute a certain proportion of a share of Great Northern and a certain proportion of a share of Northern Pacific stock to the holder of each share of Northern Securities Company's stock—that is, that there should be a pro rata distribution to the holders of Northern Securities stock, each one getting his fair proportion of the Great Northern stock and the Northern Pacific stock.

It has developed in this record, as it was developed in the case to which I am about to refer, that in the spring of 1901 the Union Pacific interests—originally the Union Pacific, but afterwards the Oregon Short Line, which is a subcompany—had acquired a large amount of the stock of the Northern Pacific Railroad Company. That stock stood in the name of Mr. Pierce and

Mr. Harriman, if I remember right, but it was owned by the Oregon Short Line.

When the Northern Securities Company was organized, a few million dollars' worth of that stock was sold and the balance of it was exchanged for stock in the Northern Securities Company. When this plan of redistributing the stocks of the Northern Securities Company was proposed, a suit was brought by Mr. Pierce, Mr. Harriman, the Oregon Short Line, and the Equitable Trust Company, with which company this stock had been deposited to secure an issue of bonds, praying that there might be a delivery back to those gentlemen and to the Oregon Short Line, not their proportion of the Great Northern and Northern Pacific stock to which they would be entitled under the plan of distribution that had been adopted, but the actual Northern Pacific stock which they had deposited, or its equivalent. That is, the Northern Securities Company or the combination of companies having been declared illegal, they asked to have the Northern Pacific stock redelivered to them. In that case they urged that it had been held by the Supreme Court of the United States that the title to that stock had not passed and that the Northern Securities Company was a mere depository, and an illegal depository, holding the stock for the members of this illegal combination.

That case eventually reached the Supreme Court of the United States, and the opinion of the Chief Justice, speaking for the unanimous court, defined what was held in the Northern Securities Company case, and, in addition to that, conclusively settled, to my mind, this question as to whether the Sherman law can be violated by the ownership, purchase, or acquisition of stock, in the same way that it can be violated by putting different concerns into some kind of a trust, as was done in the Trans-Missouri case.

This case is reported in 197 U. S. at page 244, entitled *Harriman v. The Northern Securities Company*, and I beg your indulgence while I read a few comments from it. The opinion, as I stated, was by the Chief Justice. Referring to those expressions in the opinion of Mr.

Justice Harlan, where he had spoken at one place of the Northern Securities Company as a depository, the court said:

"Counsel argue, however, that certain expressions in the opinion of Mr. Justice Harlan so enlarged the scope of the decree as to give it the effect now attributed to it by complainants.

"This suggestion is inconsistent with the settled rule that general expressions in an opinion, which are not essential to control a case, are not permitted to control the judgment in subsequent suits. But we do not think that the opinion of Mr. Justice Harlan is open to the construction put upon it. In speaking of the situation as between the Government and the defendants, the securities company is sometimes referred to as the custodian of the shares and sometimes as the absolute owner, but in the sense that in either view the combination was illegal. For the purposes of that suit it was enough that in any capacity the securities company had the power to vote the railway shares and to receive the dividends thereon. The objection was that the exercise of its powers, whether those of owner or of trustee, would tend to prevent competition and thus to restrain commerce.

"Some of our number thought that as the securities company owned the stock the relief sought could not be granted, but the conclusion was that the possession of the power, which if exercised would prevent competition, brought the case within the statute, no matter what the tenure of title was."

Therefore, in view of that interpretation of the opinion of Mr. Justice Harlan in the Northern Securities Company case, this question, which my friend has spent so much time in discussing, must be deemed eliminated from the controversy.

But if that is not sufficient, I call the attention of the Commission to the language of the court, in this same opinion, on page 297, where they had under discussion and consideration this proposition.

The Northern Pacific and the Great Northern jointly owned the Burlington, and it was claimed by the Northern Securities Company in this litigation that by reason of its interest in the Burlington the Northern Pacific was a competing line with the Union Pacific, and

that as the Oregon Short Line was owned by the Union Pacific it was in contravention of the Sherman Act to turn this stock back to the Union Pacific.

The Union Pacific was the purchaser of that stock, to use the words so often employed by my friends here—that is, of the original stock. It had bought the Northern Pacific stock in the market and it had turned that stock in to the securities company. It was seeking to get it back. It was not a question of combination, like the Trans-Missouri case, but it was a question of the owner of that stock, which had been turned in to the Northern Securities Company, getting back into its own possession, as owner, as purchaser, the Northern Pacific stock which it had so turned in. On that feature of the case the Chief Justice says:

“And it is clear enough that the delivery to complainants of a majority of the total Northern Pacific stock and a ratable distribution of the remaining assets to the other securities stockholders would not only be in itself inequitable, but would directly contravene the object of the Sherman law and the purposes of the Government’s suit.

“The Northern Pacific system, taken in connection with the Burlington system, is competitive with the Union Pacific system, and it seems obvious to us, the entire record considered, that the decree sought by complainants would tend to smother that competition.”

That is the language of the Supreme Court of the United States, where this specific question was put, and it was specifically held that the ownership of the Northern Pacific stock by the Union Pacific would violate the Sherman law. In view of that decision I do not think it is necessary to spend very much time in the discussion of this academic question, which counsel have raised here, when applied to railroad systems, located as these are, if, as a matter of fact, they are competing systems.

As I said before, the matter of intention cuts no figure, because the whole thing was thrashed out in the Northern Securities case, and it was held that the intention with which the stock was purchased was immaterial.

Railroads are natural monopolies. They are laid down along certain lines and they carry traffic over those lines. If one line in competition with another is united with that other in any manner or anywhere the effect is to eliminate, to some extent, competition and to restrain trade, under all of those decisions.

One other proposition was urged by Judge Lovett yesterday, and that is that the San Pedro road is not open to the charge of being a combination in violation of the Sherman law, for the reason that the Union Pacific built that line.

Under the decisions I can not agree in that view. Irrespective of the traffic contracts of that road, which I will refer to later, the situation as developed upon inquiry was this: Mr. W. A. Clark and certain associates organized a corporation to build a railroad from Los Angeles to Salt Lake City. They had built a portion of that road running from Los Angeles to Riverside, and they had acquired by purchase a terminal line running from Los Angeles to San Pedro, giving them access to the Pacific Ocean. The line was under construction between Los Angeles and Riverside, and surveying parties were out through the Cajon Pass and on the desert. Other surveying parties were starting at Salt Lake City and surveying to the west and southwest.

That was about 1901 and the early part of 1902. Away back in 1889 the predecessor of the Oregon Short Line, long before the foreclosure, the old Oregon Short Line and Utah Northern road, had constructed some roads in southern Utah and had projected a line leading off to the southwest. It had done some grading through a mountain canyon known as the Meadow Valley Wash, which was deemed by everybody to be practically essential in building a line from Salt Lake City to the southwest. This Meadow Valley Wash was so narrow and so crooked that if two lines of road were put through it would be necessary for them to cross each other, as I believe the testimony showed, twenty-six times.

As soon as the Clark road was projected and construction commenced and surveying parties were out, and not until then, the Oregon Short Line woke up to the fact that there had been some old right of way acquired down through this canyon and a little grading done twelve or thirteen years before. The grading had lain there and gone to decay, and the property had been sold for taxes. They thought so little of it they allowed it to be sold for taxes. The Clark people bought the tax titles.

As soon as it was evident that the monopoly of the traffic from southern California was going to be disturbed by the introduction of an independent line the Oregon Short Line immediately started up and said that they would build down through there. They commenced a series of lawsuits to enjoin the use of these old abandoned lines by the Clark people. Counter lawsuits resulted, and they all got tied up. Each one of them had injunctions against the other, I believe, all fighting to go through that valley. At the same time, as shown by the testimony, the Oregon Short Line people notified the Clark people that if they built their line through they would parallel it into southern California.

The witnesses, the counsel, and the vice-president of the Salt Lake road, who testified at Los Angeles, both swore they had projected that line as an independent line. They expected it to be an independent line. They expected to make traffic arrangements with both the Union Pacific and the Denver and Rio Grande at Salt Lake City and to run it and operate it as an independent line; but they were frightened by these threats to parallel their line and make it a financial failure. They were discouraged and stopped in their work by this litigation and with whatever other pressure may have been brought to bear, which was not disclosed by the record. At any rate, instead of carrying out the project to build an independent line, which would have been competitive in that region with the Southern Pacific, a compromise agreement was entered into which was introduced in evidence in New York, followed by

certain other agreements, and by this compromise agreement the \$25,000,000 of stock of the Salt Lake road was divided into two parts. Mr. Harriman took one part and Mr. Clark the other—or their corporations, rather—and that is trusted for a term of years, voted by the Farmers' Loan and Trust Company, the directorate is divided, the executive committee is divided, as shown by the testimony, and under traffic agreements which I will comment on later the whole road and system is actually a part of the Union Pacific and Southern Pacific.

Now, under those conditions, where the Oregon Short Line had started to build its road, as they claim, and started this litigation, and had acquired this interest for the purpose of maintaining its hold in southern California, and preventing the construction and operation of an independent line, I do not think the situation is presented that was suggested by my friend Judge Lovett yesterday, namely, that we have something like the building of a second or a double track by an existing road.

Now, this sort of thing has been commented on in the courts and in a case in Georgia, where it was proposed to build a competing line, and the proprietors of an existing line, after the road had been started, bought up the construction company and eliminated this competition in that way, it was held to be a violation of the constitution of Georgia prohibiting the consolidation of competing lines, just the same as though the line had been completed and put in operation and was afterwards bought up. So I say I do not think we have exactly the case suggested by Judge Lovett.

Now, there was another remark made in passing by one or both counsel. That is, that the effect of this has not been to eliminate all competition; that there are other lines running to the coast. As was said by Judge Lovett, where they are parallel they are a thousand miles apart with a competing line in between, the Santa Fe. That is utterly immaterial. It does not make any difference how many roads there are competing if one of the competitors is bought by another; that

is illegal. In a case decided in the chancery court of New Jersey—I have not the New Jersey citation, but it is the 17th Lawyers' Reports, annotated, page 97—it was held that where one coal road proposed to acquire another coal road, where there were six competing, it was not necessary for the Government to stand by or the State to stand by until the monopoly was complete, but the Attorney-General was entitled to his injunction against the acquisition of the second road by the first. So I do not think that can be seriously urged. I think it was, perhaps, a remark made in passing by Judge Lovett.

So, for all these reasons that I have suggested, it seems to me there can be very little doubt that we have presented here a violation of the law of 1890—the Sherman law—if, as a matter of fact, the Southern Pacific line was a competitive line with the Union Pacific. I think we are thrown back to the question which Judge Lovett argued very well yesterday, as to whether in fact they are competitive lines, because if they are, I think it must be conceded that under the decisions of the Supreme Court of the United States the manner in which that control is exercised and the fact that it is exercised by means of ownership, by means of purchase, is quite as sufficient as though it were done in some other way.

Now, let us see whether the evidence here fairly discloses the fact that these are lines which are not susceptible of being put together in the manner that has been employed or in any other way.

The Southern Pacific line, so far as its rail lines are concerned, begins at New Orleans and runs through the States of Louisiana and Texas and the Territories of New Mexico and Arizona, thence through California, up to Portland, Oreg. It also has the other line running east from Sacramento to Ogden, Utah, with various branches and feeders.

The Union Pacific begins at Omaha on the Missouri River and goes west to Ogden, and with its connections or subcompanies, the Oregon Short Line and the Ore-

gon Railroad and Navigation Company, proceeds also to Portland, Oreg., so that both lines start at Portland, Oreg.—the rails of one end at the Mississippi River and of the other at the Missouri River. They both have rail connections into the Chicago territory, so called. The Union Pacific has rail connections into the Atlantic seaboard territory, and that territory is reached not only by rail connections, but by the boats of the Southern Pacific running from Galveston and New Orleans.

Now, going back to the Pacific coast, at the time of the purchase of this stock the Southern Pacific was operating its line from Portland to San Francisco, and the Union Pacific interest—that is, the Oregon Short Line—was operating in competition with that line a line of steamers from Portland to San Francisco. That those lines were competing and that they are still each seeking for business is undisputed, although Mr. Jones, the general traffic manager of the Southern Pacific, testified at San Francisco that as far as rates are concerned they go up and down automatically. If the steamship rates are put up, the rail rates go up. He said it was not even necessary to refer that matter to him, because the rate clerks had instructions that whenever the steamer rates went up they should put up the rail rates.

Mr. LOVETT. Established differentials?

Mr. SEVERANCE. Yes; that is right; established differentials. When I asked him if he thought that was fair, when the steamship rates had been put up by reason of the increased expense of handling the business, which had been testified by the manager of the steamship company, he said he thought it was quite fair. So we have a rate clerk competition now between San Francisco and Portland. That those lines were competing lines for passengers and for freight of course can not be controverted. In addition to that, in the old days the Oregon Railroad & Navigation people ran a line of boats on the Willamette River to pick up traffic that was competitive with the Southern Pacific and take it into Port-

land, where it was put into cars and shipped to the East or to San Francisco or wherever it might go. They were run in connection with the rail lines.

So that there existed those competitive conditions there. Then the testimony in this case shows that from all the Chicago territory and all along the line of the Illinois Central—the control of which has now been acquired by the Union Pacific—all along that line there was active competition for Pacific coast business. That is testified to by Mr. Markham, formerly assistant traffic manager for the Illinois Central for a great many years.

MR. LOVETT. Mr. Severance, you do not claim there is any evidence that the control of the Illinois Central has been acquired by the Union Pacific?

MR. SEVERANCE. Yes; I claim that for this reason. I claim that absolutely on the testimony of Mr. Kahn, given in New York. It appears by the testimony in the case that the Union Pacific have purchased about 29½ per cent of the stock of the Illinois Central, and Mr. Kahn testified that under ordinary conditions that was sufficient to dominate and establish the control. He said that it would maintain the control except in case extraordinary efforts were made to organize the rest of the stockholders.

MR. LOVETT. There is no dispute about the fact that the ownership is only 29½ per cent?

MR. SEVERANCE. That is right.

MR. LOVETT. The rest is legal conclusion?

MR. SEVERANCE. No; I do not agree to that, Judge Lovett. I do not think it is a legal conclusion for this reason. Gentlemen like Mr. Kahn are advised, as other witnesses have testified, Mr. Ripley and others in this case, as to what is the usual and ordinary practice of stockholders in sending in proxies or attending meetings, so that it goes a little beyond a matter of a legal conclusion. The fact is that the way railroad stocks are scattered—this is in the record—the way railroad stocks are scattered and held by brokers and by various people here and there in small blocks or in large blocks, for that matter, it is impossible to get a full vote out at

a stockholders' meeting. It further appears that the persons in control of the property, having control of the stock books and the lists, and getting up proxy committees, and sending out the stock proxies, have a very large advantage in maintaining control; so that, taking all those things into account—I assume Mr. Kahn took them into account when he stated that the $29\frac{1}{2}$ per cent was enough to make a substantial control.

Mr. LOVETT. Will you allow me to interrupt you again?

Mr. SEVERANCE. Certainly.

Mr. LOVETT. Am I to understand that you express the legal opinion to the Commission, as its counsel, that $29\frac{1}{2}$ per cent of the stock of the Illinois Central is the control of that road?

Mr. SEVERANCE. I say under ordinary conditions it is. That is the evidence in the case. In the absence, Judge Lovett, of an organized effort.

Mr. LOVETT. You recognize that as a legal question, do you not, as to whether or not it does?

Mr. SEVERANCE. No; I do not. I think it is a question of fact, in view—of course I am not so absurd as to stand here and say that $29\frac{1}{2}$ is 51. I do not say $29\frac{1}{2}$ is a majority of the stock, but I say under ordinary conditions surrounding stockholders' meetings any person holding a block of $29\frac{1}{2}$ per cent of the stock and having control of the stock books and the means of securing proxies would be very difficult to dislodge. I think it would amount to substantial control, yes; and I am basing that on the testimony in the case. I am not claiming, of course, that that is a legal majority—that $29\frac{1}{2}$ is $50\frac{1}{2}$.

Mr. MILBURN. You are not contending that 29 is more than 71?

Mr. SEVERANCE. I am not claiming that at all, but I do claim that the testimony very clearly shows that the 71 does not turn out at the stockholders' meetings.

Mr. LOVETT. Do you claim that such a control would be a combination contrary to the antitrust act, if the lines were competing?

Mr. SEVERANCE. I think that is a question of fact, as I said before.

Mr. MILBURN. You see, we are holding you to a little more rigid rule than the ordinary counsel, because you are the adviser of the Commission.

Mr. SEVERANCE. I am suggesting only what appears in the record from your own clients, or Mr. Cravath's client, rather, and from Mr. Ripley, who is at least on fairly cordial terms, I assume, with the Union Pacific interests.

Mr. Markham testified, as I said, that while he was with the Illinois Central there was a competition for that business. In discussing this matter yesterday Judge Lovett said Mr. Neimyer, who was, before the consolidation or before the acquisition of the Southern Pacific stock, the agent only of the Southern Pacific, who is now the joint agent of the Southern and Union Pacific, was in the habit of soliciting all the business of the Southern Pacific to go over the Ogden route. That is not in accordance with the statement made by Mr. Markham, who was the gentleman who received the solicitations, and Mr. Neimyer himself was not introduced as a witness. Mr. Markham says that one Mr. Knight represented the Union Pacific, and that he and Mr. Neimyer were fighting for that business along the line of the Illinois Central.

It appears further that all the business east of a line drawn about on Pittsburg and Buffalo takes the same rate to the coast and is moved both ways; that is, by the rail lines by Omaha, and by the rail lines to seaboard, and then by the boats around through Galveston and New Orleans and the Southern Pacific line to the coast. All that traffic, the New England traffic, and all that, is moved on equal rates, the Southern Pacific absorbing the rate from the point of origin to the seaboard, so that practically all the business east of the Missouri River can go at the same rate to the Pacific coast by either one of these two lines, either the Southern Pacific and its connections, the Southern Pacific and its steamers and its connections, or by the

Union Pacific and its rail connections, the only difference being that it would be delivered by the Union Pacific at Omaha by its eastern connections and be delivered to the Southern Pacific at Galveston, New Orleans, or New York by some other rail connection.

Now, again, it appears without controversy that prior to the acquisition of this stock the Oregon Railroad & Navigation Company, which is the Union Pacific, had for a number of years, either by the ownership of the corporation itself or by arrangement with some ship-owners, maintained a line of steamers from Portland to the Orient. The Union Pacific had also owned one-half the stock of the Occidental and Oriental Steamship Company, the balance of that stock being held by another corporation called the Pacific Company, I believe—the Pacific Improvement Company, or some such name—and since 1901 three-fourths of the stock of that other company has been acquired by the Union Pacific, so that at present it owns seven-eighths of the Occidental and Oriental. On the other hand, the Southern Pacific line at that time owned a majority of the stock of the Pacific Mail Steamship Company, and the Pacific Mail Company was also the agent for a Japanese line running to San Francisco, which connected with the Southern Pacific. Consequently, at the time of this amalgamation we had the Union Pacific with a half interest in the Occidental and Oriental and having a line of its own from Portland, and the Southern Pacific with the Pacific Mail, or control of it, and the Japanese line there, which was operated in connection with it.

It is in evidence that all of these lines brought to the Pacific coast a large amount of traffic from the Orient—curios, mattings, silks, and other Japanese goods and Chinese goods—and that those were sent forward to the East over the lines of the respective roads with which the steamships were affiliated. Consequently at that time we had traffic moving to the East over the Oregon Railroad & Navigation, which arrived from the Orient at Portland. It appears that the contracts with the

shipowners required that it move over the Oregon Railroad & Navigation, and not over the Southern Pacific, and the contrary existed at San Francisco.

Now, at the present time all of these lines have been put under the common management of Mr. Schwerin, who is also in the management and control of the lines from Portland to San Francisco, the old boat line formerly run by the Oregon Railroad and Navigation Company. That has been taken out of the Oregon Railroad and Navigation Company and put in a separate company, and Mr. Schwerin manages that. He has charge of all the steamships on the Pacific Ocean, no matter what their former relations were.

That was about the situation of these properties at the time this stock was acquired. Since that time certain changes have been made. I have spoken already of the situation between the steamships and the rail lines between San Francisco and Portland. Further than that, there used to be competition into Portland, both between the Sunset route, from the east on the one hand and the Union Pacific and its connections on the other, and also the Southern Pacific by Ogden.

Now, the Sacramento gateway, so called, the point at which the Ogden line meets the line from Portland, has been closed to traffic from Portland. We find at Portland at this time a general freight agent, who represents the Oregon Railroad and Navigation Company and the Southern Pacific Company jointly. We find the same operating official, Mr. O'Brien, the manager—the car-service agent—a complete amalgamation, to all intents and purposes, in all that region in northern California and Oregon; and the testimony shows there was a large lumber traffic and wool traffic and hop traffic moving to the east and to the mountain States, which was competitive between these lines, and that competition has been eliminated.

Counsel says it only amounts to, I think, one-tenth of 1 per cent of the traffic of the Southern Pacific. I do not know what he includes in that one-tenth of 1 per cent.

Mr. LOVETT. I say of the two systems—not of the Southern Pacific, but of the two systems.

Mr. SEVERANCE. Well, I do not know what traffic is included, whether that includes lumber and wool and hops, and all the other products that go there, together with merchandise, out or not. Of course I do not know.

Mr. LOVETT. Everything.

Mr. SEVERANCE. There is no evidence in the record—of course I am sure Judge Lovett believes it shows that or he would not state it—but there is no evidence in the record as to the extent. It is admitted, however, that competition has been absolutely eliminated; and it has gone to this extent: All the business of Oregon from as far south as Ashland, on the Southern Pacific—Ashland is about 400 miles, if I remember, south of Portland—all the business going to the east that originates on that 400 miles of the Southern Pacific moves by way of Portland and thence over the Oregon Railroad and Navigation and thence by the Union Pacific.

Mr. LOVETT. Will you allow me to interrupt you?

Mr. SEVERANCE. Yes.

Mr. LOVETT. Of course you do not contend that any of the business as far south as Ashland was ever in competition, or anything south of Salem, about 60 miles from Portland? The Union Pacific never had any line south of Salem.

Mr. SEVERANCE. That is true.

Mr. LOVETT. It was solely business, I said, that it might send any way.

Mr. SEVERANCE. That is true. Oh, it was above Salem. The competitive business was about 90 miles, or—

Mr. LOVETT. Sixty miles.

Mr. SEVERANCE. Well, whatever the record shows; but I was calling attention to the situation that exists there. That traffic, instead of moving over the Southern Pacific, is sent up to Portland and sent east over the Union Pacific. That may be a matter of no special consequence to the public. It may be a matter of some

consequence to the Southern Pacific stockholders, the minority stockholders—or rather the majority stockholders—the stockholders other than the Union Pacific, whose business is being sent around that way instead of flowing out to the south over the Southern Pacific. I am merely stating the situation that exists. The competitive business, as stated by Judge Lovett—he is quite correct—only went up for a few miles.

Mr. LOVETT. In view of your reference to the stockholding interests, will you not state in that connection that, the testimony shows—

Mr. SEVERANCE. I was just going to do that.

Mr. LOVETT. That the Southern Pacific made the division to avoid the hauling of this traffic over two mountain ranges?

Mr. SEVERANCE. I was going to state that. There was a new division made by Mr. Stubbs, acting for both roads, in which he tried to make up to the Southern Pacific as best he could what it lost by reason of moving its traffic by Portland. I was just starting to say that when you interrupted. But that of course was Mr. Stubb's best judgment, acting for both roads.

Now, as to whether these lines I have sketched in this way were competitive lines, not only the railroads, but the steamers, is a question of fact. It is not a legal deduction, but it is a question of fact, and upon that question of fact there does not seem to be much diversity of opinion from railroad men who have been familiar for many years with railroad affairs. Mr. Stubbs, who certainly can not be accused of being prejudiced against these respondents here, testified in Chicago that in the old days prior to the interstate-commerce law there was competition between all the lines to California, and there was a pool between the Southern Pacific and the Union Pacific, and that each one was accorded its percentage, and that he was fighting for as large a percentage as he could get for the Southern Pacific line. Mr. Markham's testimony I have already referred to.

Mr. LOVETT. Mr. Severance, I am sure you do not intend to misstate Mr. Stubbs's testimony.

Mr. SEVERANCE. Of course I do not.

Mr. LOVETT. The percentage that was allowed the Union Pacific and the Southern Pacific, to which he testifies there, was a division of the percentage allowed the line made up of the Union Pacific and the Central Pacific. Of course that was divided between them.

Mr. SEVERANCE. Yes; but the line——

Mr. LOVETT. As connecting, not as competing lines.

Mr. SEVERANCE. No; I beg your pardon. You are mistaken about that. I will read you the testimony. You are wrong about that, Judge Lovett.

Mr. LOVETT. All right.

Mr. SEVERANCE. His attention was particularly called to the Sunset route and also to the other lines. He spoke of that other line. Of the two together—that is, the one line made up of the Southern Pacific. That is, the Central——

Mr. LOVETT. Of course the Sunset route got a share too.

Mr. SEVERANCE. Certainly it did. That is what I mean.

Mr. LOVETT. All the transcontinental lines got a share.

Mr. SEVERANCE. That is it exactly.

Mr. LOVETT. But the share allowed to the Southern Pacific was for the all-rail line that was divided between the Central Pacific and Southern Pacific as connecting lines.

Mr. SEVERANCE. Very good. There was a division of this through business—this transcontinental business—between the members of a pool, and one line was made up of the Union Pacific and the Central Pacific and the other was made up of the Sunset. That is correct, is it not?

Mr. LOVETT. That is correct.

Mr. SEVERANCE. That is it exactly; and in those meetings each one was contending for all he could get, and the Sunset was contending for more as against the Union Pacific line, in connection with the Central Pacific at Ogden.

Now, Mr. Hannaford was examined about that:

"Q. Mr. Hannaford, in the old days prior to the enactment of the interstate-commerce law, which was in 1887, were you familiar with traffic meetings that were held by the transcontinental roads? Did you attend those meetings?

"A. I attended them all, I think, except during the winter of 1886 and 1887.

"Q. You had been attending them for several years, hadn't you?

"A. Yes, sir.

"Q. Prior to that time did you often meet Mr. Stubbs at those meetings?

"A. Yes, sir.

"Q. What road was he representing?

"A. The Southern Pacific.

"Q. Who represented, if anyone, the Union Pacific at those meetings?

"A. Well, various officials of that company; the late Thomas M. Kimball and, I think, Mr. Vinning when we first met Mr. Clark, the general manager, and Mr. Shelby, Mr. Munroe, and whoever their traffic official in charge was at that time.

"Q. Now, at those meetings were there discussions as to divisions and pools of transcontinental business?

"A. Prior to 1887 there was.

"Q. Yes; that is what I mean; prior to 1887.

"A. Yes, sir.

"Q. Did the Union Pacific and Southern Pacific figure as independent parties to those pools; separate parties?

"A. Separate roads; yes, sir."

Commissioner LANE. What did that pool include?

Mr. SEVERANCE. That included the Northern Pacific, the Union Pacific, and the Southern Pacific.

Mr. KELLOGG. All lines west of the Missouri River.

Mr. SEVERANCE. All lines west of the Missouri River. The Commission are probably aware of the fact that the lines west of the Missouri are, in common railroad parlance, known as the "transcontinental lines," and that was the transcontinental pool.

Mr. Hannaford further testifies:

"Q. Mr. Stubbs was endeavoring to get as large a percentage of the business as he could for the Southern Pacific system?

"A. The indications pointed that way.

"Q. What you mean by indications is that that is based on what Mr. Stubbs said, his arguments in the meeting?"

"A. Yes; certainly.

"Q. And Mr. Munroe or the other gentlemen, whoever they may have been, who represented the Union Pacific, were likewise trying to get as large a percentage as they could for that line?"

"A. As large a percentage of earnings or as small a percentage when it was a division of expenses."

Then he was asked whether prior to 1901 he was familiar with traffic conditions so far as transcontinental and overland business was concerned. He said he was. He was asked whether there was active competition prior to that time throughout the Atlantic seaboard territory and the Chicago territory between the different transcontinental lines for the Pacific coast business. He answered that there was.

"Q. All the roads were competing for that business?"

"A. Well, all of the roads lying west of a line drawn north and south through Chicago.

"Q. What Pacific roads were competing for it? The Southern Pacific was competing for it, wasn't it?"

"A. Yes, sir.

"Q. And the Santa Fe?"

"A. The Southern Pacific, with some restrictions of territory.

"Q. And the Santa Fe?"

"A. The Santa Fe.

"Q. And the Union Pacific?"

"A. The Union Pacific.

"Q. The Northern Pacific?"

"A. The Burlington and the Denver and Rio Grande roads. The Northern Pacific at the date you mentioned; the Great Northern and the Canadian Pacific were the principal lines. Of course they had lines that led up to them.

"Q. Now, has the Sunset route, the Southern Pacific, been one of your competitors at Portland on business originating in the Atlantic seaboard States?"

"A. Yes, sir.

"Q. How is that?"

"A. Yes, sir.

"Q. Has the route made up of the Union Pacific and Oregon Short Line and the Oregon Railroad and Navigation Company likewise?"

"A. Yes, sir."

Mr. Hiland, of the Milwaukee and St. Paul, testified, at pages 153 and 154——

Commissioner CLEMENTS. Mr. Severance, we will suspend here until 2 o'clock.

The Commission, at 12.30 o'clock p. m., took a recess until 2 o'clock p. m.

AFTER RECESS.

The Commission reassembled at the expiration of the recess.

Commissioner CLEMENTS. You may proceed, Mr. Severance.

ARGUMENT OF C. A. SEVERANCE RESUMED.

Mr. SEVERANCE. Now, there are two considerations that enter into this matter of competition between the Sunset route and the lines made up of the combination between the Union Pacific and the Ogden line to San Francisco. In the first place, the testimony discloses, as I have already said, that commodities can move either way at the same rates. In the second place, there was originally a distinct and active competition for the business conducted, on the one hand, by the Southern Pacific, and, on the other hand, by the Union Pacific; that is, between the Sunset route and the Union Pacific.

Then, again, competition in rates now is so largely eliminated that the competition of the future is competition in service and in facilities. With a thousand miles of road running from the Missouri River to Ogden, irrespective of all the other considerations that have been suggested, there is the foundation for a most active and energetic competition. Leaving the rates as they may be, leaving them to be made up as they may be, giving the Southern Pacific all the advantage of its position and all the influence it can possibly have in the making of these through transcontinental rates, still it could have no control whatever over the service on the Union Pacific, on the rapidity of the service that way.

Then, again, there is a very large traffic, as is disclosed by the testimony, into Colorado common points, coming from the seaboard, that moves over the Union Pacific from the Missouri River and moves around by the Gulf ports and over connections of the Southern Pacific, where this alleged advantage of control of the Southern Pacific cuts no figure, because those commodities that move over the Union Pacific to Colorado common points do not touch the Southern Pacific at all.

I will hasten along, because I am anxious to get through. I am merely throwing out these suggestions to the Commission.

As to oriental business, Mr. Stubbs testified, at page 88, that it was active competition at all times. He says there is, even at the present time between the Portland route and the San Francisco route. Mr. Stubbs testified to that, reaffirming what he said in his testimony in a suit brought by this Mr. Graham, who was a witness and who is not considered of much consequence by my friend Judge Lovett, as he said he would not discuss what Graham said.

The testimony shows that in the old days there was rate cutting between the Sunset route and these others, the other lines; that the Sunset, by reason of being a longer line, cut rates and fought for the business, and in passing it is interesting to consider Mr. Milburn's suggestion about the length of the line. He said it can not be competitive because it is 5,000 miles around by New Orleans or Galveston and only 3,000 miles across the continent.

I could make a much more extreme comparison than that. It is very much farther around Cape Horn than it is by the Sunset route, infinitely farther; but the strongest competition, the competition that it is claimed should hold down rates to the Pacific coast points from the East is the competition of the Cape Horn route and of the Panama route, which is several thousand miles longer than these others. It is not the length of the route that is important. It is not the fact that to get to San Francisco over the Oregon Railway & Naviga-

tion to Portland and then down by boats is a longer route than the route out through by Ogden. The important feature of the matter is that the traffic can be moved either way, and so far as these long lines around Cape Horn are concerned, it still moves in that way, by the Hawaiian lines, as testified, and moves by Panama and then up by the Pacific Mail. So that the length of the route is immaterial. The competition is there. Competition has always been there, and the competition did exist, as I have shown, away back prior to the enactment of the interstate-commerce law, and there was a division of the through business.

Just a few words about this Clark road. I this morning discussed its history. It has also developed in connection with that road—and this all bears on the situation out there, for I understand this investigation is to cover the whole traffic situation there—it developed in the course of the inquiry that certain traffic contracts had been made, one with the Southern Pacific, one with the Union Pacific and Oregon Short Line, on the one hand, and the San Pedro road on the other; and at Los Angeles we examined very carefully the witnesses, the gentlemen who had been concerned in the making of these contracts, so as to receive any explanation that could be made of them.

Now, as to the Southern Pacific, it has already been referred to. Article 2 of the Southern Pacific agreement provides that:

“In partial consideration of the said covenants and agreements of the said Southern Company, contained in Article I hereof, said San Pedro Company hereby covenants and agrees with the said Southern Company that it will, upon the execution of this agreement, adopt, print, publish, and put in force, at all points upon its leased, owned, or operated railroad, for the handling of local business thereon, the local rates, tariffs, classifications, and charges used by said Southern Company for the handling of any local business which may be the subject of competition between them.”

And Article III provides that after these rates are so put in there shall be no change for ninety-nine years without the consent of the two lines.

It was argued there, and was explained by the officials of the San Pedro road, that that was intended to apply only to business local to southern California; but there is a provision which was not satisfactorily explained to my mind by the counsel for the San Pedro in this third paragraph, which is that these rates shall be maintained for ninety-nine years unless it is necessary to change them by reason of some lawful and valid requirement of State or national law, which would indicate that it was in the minds of the parties—it must have been—that this would refer not only to local, but to interstate traffic.

Suppose that in the future the San Pedro road, as it naturally will, builds branch lines in southern Nevada and in eastern California, into territory where it will be competitive with the Southern Pacific. This contract is effective as to that. It covers all the roads that may be operated for ninety-nine years, and in defining this word "local" it is sought to confine that to California, so as to take it out of the jurisdiction of this Commission, or rather out from under the operation of the Sherman Act; but a little further on in the hearing at Los Angeles, when Mr. Wells, the general manager of the San Pedro road, was asked to make up a statement of the shipments, the number of cars of fruit shipped to the East over the San Pedro road, he made up a statement, and it was divided by himself or the men who made it up—and he presented it—it was divided between local and through, and "local" meant everything west of the Missouri River. That was the very next day after this explanation had been made that "local" referred only to southern California.

Judge Lovett practically conceded yesterday that "local" in railroad parlance means local to the line. I can conceive of traffic local to the San Pedro line and local to the Southern Pacific between Ogden and Salt Lake, as far as that is concerned, although they are 37 miles apart. It might be local to either and competitive.

Then, again, they were not content with that contract, but they made another traffic contract of a more extraordinary character between the Salt Lake road and the Union Pacific and the Short Line, its subcompany, they being of the one part and the San Pedro of the other.

It is provided by Article II, section 1:

"Said San Pedro company hereby covenants and agrees to and with said Short Line company that it will not hereafter, during the time of this agreement"——

and ninety-nine years was the term——

"extend its said main line of railroad, or any of its branch lines of railroad, nor construct or build any lines of railroad, or aid any other company or companies in the construction or building of any line of railroad, nor assist or advise in the building or construction of any other railroad"——

They made it as strong as they could possibly make it, you see. They can not even advise somebody else to build a line of railroad——

"of any other railroad than the said lines of railroad described in Article I hereof, northward from Salt Lake City, or which may run into the territory northward of the parallel of Salt Lake City, Utah."

That is, the San Pedro Railroad for ninety-nine years can not build into the territory north of Salt Lake City, where they will become competitors of the Oregon Short Line or the Union Pacific or Southern Pacific as part of the system. For ninety-nine years they are prohibited from even advising anybody to build a railroad in there.

Then the Short Line Railroad Company turns around and covenants and agrees to and with the San Pedro company:

"That it will not build or construct any railroad or branch lines of railroad, or aid any other company or companies in the construction of any railroad which will in any manner, either directly or indirectly, enter into the territory or invade the territory south of said Salt Lake City, or south of the parallel thereof, nor so as to in any manner invade or encroach upon the territory of said San Pedro company lying south of Salt Lake City," and so on.

“Nor shall the same be constructed, built, used, or operated for the purpose or with the effect of diverting the business naturally tributary to said San Pedro company’s railroad south of Salt Lake City, or any business originating at or delivered to points located in territory south of Salt Lake City from said San Pedro company, or to said Short Line company’s railroad, or any other railroad or railroads.”

There is a provision by which a dead line is drawn at Salt Lake City for ninety-nine years, and these two lines of railroad agree that they will not invade each other’s territory for that period.

Then again, and a very interesting provision in this contract, is one relating to rates in and out of Utah points—interstate rates.

Section 6, article 4:

“It is covenanted and agreed that said Short Line company and its connections, the said Union company, and each of them, shall have the right to name and make the through rates between points—that is, in both directions—on or reached by their respective lines and points on the line of said San Pedro company’s road in Utah for business which said Short Line company or said Union company might give to or receive from said San Pedro company in competition with any and all other connections of said San Pedro company, provided, however, that on demand said Short Line company and said Union company shall join said San Pedro company in any through rates necessary to meet the rates offered by any competing line for such business.”

Now, until it is necessary to meet competition the San Pedro absolutely abdicates its power to make rates or to be consulted in the making of rates in or out of Utah, but that is absolutely turned over to the Union Pacific.

It is hitched onto the end of the Union Pacific as much as though it had been sold to the Union Pacific, so far as the power to make rates is concerned. It is a common thing that rates are made—I think it is quite usual that rates are made by the originating carrier; but here it is specifically provided that in both directions, in and out, the rate shall be made by the Union Pacific.

Then there is a very interesting provision in this contract, which is to the effect that nothing in the contract contained—I will not stop to read it—but that nothing in the contract contained shall be deemed in any way to interfere with the business done by the Union Pacific in connection with the Southern Pacific.

So that the Clark road, as a factor, as a possible competitive factor in any way, shape, or manner for a period of ninety-nine years, is absolutely eliminated, and it is made part of the Union Pacific system.

Taking those things in connection with the history of the road and the way it was created, I think it goes very far beyond that Judge Lovett yesterday suggested, namely, that it was nothing more than the construction of an additional or double track.

Mr. LOVETT. A partnership.

Mr. SEVERANCE. A partnership; yes.

Now, with reference to the Santa Fe, just a few words, because there was an inquiry into the relations between the Santa Fe and the Union Pacific system. It appeared at the hearing in New York that \$10,000,000 of the stock of the Santa Fe road had been purchased by the Union Pacific. It appeared by the testimony of Mr. Ripley that Mr. Harriman had demanded a representation on his board, that he found out that about \$30,000,000 of stock was controlled by Mr. Harriman and his associates, and that under the cumulative system of voting they could elect two directors. Consequently he told them that they might elect two directors, but he did not want him to elect any officials of the Union Pacific. He said he would not have officials of the Union Pacific on his board. So they chose Mr. Rogers and Mr. Frick, both of whom were directors of the Union Pacific. In the law books directors are classed as officials, but they are not classed as officials by Mr. Ripley in his testimony. But there is the relation between these companies. Whether this \$10,000,000 of stock that was bought by the Santa Fe was purchased from Mr. Harriman and his associates, who had the \$30,000,000, does not appear by the testimony. If

it was, then they still have \$30,000,000 of stock among them. Otherwise they have \$40,000,000. But this situation does develop, and it is important in considering the whole traffic situation in California. It appears that some years ago the Santa Fe road had a line of steamships to the Orient from San Diego. It was not a profitable line, that is true; and the Pacific Mail Company, the majority of the stock of which is owned by the Southern Pacific, made arrangements with the officials of the Santa Fe to discontinue that independent service and take their oriental freight to San Francisco upon an understanding, indefinite as to amount, as stated by Mr. Schwerin, but an understanding that they were to be fairly taken care of in the matter of oriental traffic.

It appears from Mr. Schwerin's testimony that the steamship company which maintains a full organization in the Orient and solicits its traffic has the disposition of the freight, so far as its forwarding to the East is concerned. They can route it, and he says that about the middle of last summer—his testimony was that it was about six months ago, and the testimony was given in January—about the middle of last summer, Mr. Schwerin, the vice-president of the Pacific Mail, and the general freight agent of the Santa Fe, and the general freight agent of the Southern Pacific, made an agreement that instead of Mr. Schwerin dividing this traffic as he had been doing in somewhat disproportionate percentages, that thereafter until some new deal was made it should be divided evenly between the two lines. That deal was made sometime, of course, after the Union Pacific men went on the Santa Fe directorate. It was made last summer, and he says the way it is done now is this. When a ship comes from the Orient loaded with a cargo which is to be carried to the East, they give it to the Santa Fe. When the next ship comes in loaded with a like cargo, he delivers it to the Southern Pacific.

Mr. LOVETT. It was 25 per cent; not evenly.

Mr. SEVERANCE. No; I beg your pardon. It had

formerly been divided 75 and 25 per cent, but he says since last summer, under this agreement, it is divided one shipload to one and one shipload to the other.

Mr. LOVETT. My understanding is that the testimony was that formerly it was divided, each cargo, certain proportions of it, 25 and 75 per cent, and subsequently it was changed so that distribution was by ships, that one road would get all of one cargo and the other road all of another cargo, but not evenly, still maintaining the percentage.

Mr. SEVERANCE. Mr. Lovett, it is not important as to the percentage, but I am quite sure you are mistaken about that.

Mr. LOVETT. All right.

Mr. SEVERANCE. You recall very well that he testified that the steamship companies now delivered one cargo to the Santa Fe and the next cargo to the Southern Pacific, do you not, and have for the last six months?

Mr. LOVETT. They delivered one cargo to one company and another cargo to another, but not alternating all the time.

Mr. SEVERANCE. I think his testimony is that they do alternate, and have since last summer. Previous to that it was divided on a different basis.

Mr. LOVETT. It is not material.

Mr. SEVERANCE. It is not material, but it is apportioned. If there is an arrangement by which certain traffic is arbitrarily divided in that way, it is a matter for the consideration, perhaps, of the proper officers of the Government who have to do with such things. That is traffic which is landed there and which is divided in that way. I am speaking of the relations between these companies.

Again, it was testified there by Mr. Bissell, the assistant freight traffic manager of the Santa Fe, approving really what Mr. Stubbs himself had testified in another hearing, that there is no competition between the two lines, the Santa Fe and the Southern Pacific, for the citrus-fruit business out of southern California. This

is a very large traffic, and they say it was agreed several years ago that there should be no competition between them, that is, they would not seek for each other's business; but, curiously enough, although the testimony at Los Angeles showed that 60 per cent of this fruit was tributary to the Santa Fe—that is, the packing houses that shipped 60 per cent of the fruit were on the tracks of the Santa Fe—Mr. Woodford, the manager of the Southern California Fruit Exchange, which ships about 47 per cent of all the fruit in southern California, I think about 12,000 or 14,000 carloads a year, and who is kept in touch, by means of circulars sent to him by the various lines, with the amount of shipments moving each way, testified that last year almost exactly 45 per cent went by the Santa Fe, instead of 60 per cent, 45 per cent by the Southern Pacific, and 10 per cent by the Salt Lake.

So that in some way or other this result came about. It is admitted by Mr. Bissell and Mr. Stubbs that there is no competition; but in some way, which is not disclosed—the result is disclosed—there is that arrangement, or at least that result is reached, by which 45 per cent went by the Southern Pacific, 45 per cent by the Santa Fe, and 10 per cent by the Salt Lake road.

Then, again, another thing came out there, which shows the relation between these various companies. It appears that when the Salt Lake road was first opened it put on a fast train to Chicago with fruit—a six-day train. The fruit men testified that it was a matter of several hundred dollars a car sometimes to save a couple of days in transit. That ran a few trips. Mr. Wells, the general manager, said that the other lines protested vigorously against running that train, because their lines took eight or nine days to make the trip, but he said they did not abandon it for that reason. Commissioner Lane asked him why it was—if it simply just stopped—and he said, "Yes; it just stopped," and it has never been resumed.

Those relations exist out there, and taking into ac-

count the situation as between the Southern Pacific and the Santa Fe between the Salt Lake road, controlled, managed, hand and foot, as it is, by the Union Pacific system, it looks to me as though there is not a very vigorous competition, to say the least, in the large business out of California.

Recently another thing has been done there that shows what Mr. Harriman called the—he did not like “community of interest,” but some word like it—common interest of the companies.

Mr. KELLOGG. Harmony in management.

Mr. SEVERANCE. Harmony in management; yes. That is, that in northwestern California there were a number of lines of road which belonged to the Santa Fe and a number belonging to the Southern Pacific. It was testified there by the officials in San Francisco that these lines of the Santa Fe were secured with the intention of building up a connection with San Francisco Bay. It was also testified that it was the intention to extend the Southern Pacific up there into the great timber country of northern California. Instead of that they have organized a company called the Northwestern Pacific, which has taken over all these lines. Half of the stock is owned by the Southern Pacific and half by the Santa Fe. The connections are to be built by this new company and the control is to be ostensibly handed back and forth each year in the same way as in the Alton contract with the Rock Island, which has been referred to in this testimony.

Now, as to the effect of the lack of competition in Oregon, there is a lot of testimony in the record, given by the most prominent business men in the city of Portland, which shows that for years they have been struggling to develop their State. They have seen Washington on the north growing and being developed, but Oregon at a standstill. With the Southern Pacific running up toward the westerly side of the State, the Oregon Railroad & Navigation on the north, the Oregon Short Line on the northeast, if those lines were competitive lines, with the immigration into the west that has taken place in the last few years, it is incon-

ceivable that 50,000 square miles—for that is the amount testified to—of central and southern Oregon should be left without railroad facilities. Each line would have been going in there to get that business and develop the country and build it up, and great bitterness was displayed there by some of the witnesses, the business men of Portland, because of the failure to do anything to develop that country, while large earnings were being taken out of Oregon by those lines and used to buy stocks, as they put it, in eastern lines in no way connected with that business.

It appears that since the last annual report the Union Pacific has bought stocks in the New York Central, in the Baltimore & Ohio, in the Chicago & Northwestern, in the Chicago, Milwaukee & St. Paul, and in the Illinois Central. It was explained on the stand that these stocks were bought to use up the money that had been made out of the Northern Securities deal. The Union Pacific, claiming the right to act as an investment company, having that right, perhaps, under its charter, raised money, as was shown in the testimony, \$100,000,000 of convertible bonds being sold to buy Southern Pacific and Northern Pacific stock, and afterwards \$45,000,000 of bonds of the Oregon Short Line for this same purpose. They acquired this Northern Securities stock. Owing to the fact that stocks were up, they made a large profit. If they had gone down, the Union Pacific would have been very much embarrassed in carrying on its functions as a railroad enterprise, but they went up and they made a profit. Then they reinvested these funds as they sold out the Great Northern and Northern Pacific stock in the stocks of these various lines, except as to the Baltimore & Ohio, and the Baltimore & Ohio they went in debt for—every dollar of it.

Mr. KELLOGG. Not every dollar.

Mr. SEVERANCE. Practically every dollar.

Mr. KELLOGG. Thirty-six million dollars.

Mr. SEVERANCE. Yes; pardon me; \$76,000,000 and some hundreds of thousands of dollars. They went in debt for that. Mr. Kahn explained that it was in an-

ticipation of selling some more Great Northern and Northern Pacific stock. If the Commission will look at the present quotations of Great Northern and Northern Pacific it will be seen that the amount of stock they had on hand undisposed of falls short, by a good many million dollars, of being enough to pay for this Baltimore & Ohio stock.

Now, it is a matter that I think should be seriously considered by this Commission, whether any recommendation should be made with reference to future legislation curtailing the right of a railroad corporation engaged in interstate commerce to engage in stock speculations, with all their attendant dangers.

MR. LOVETT. Will you allow me to interrupt you a moment, Mr. Severance?

MR. SEVERANCE. Certainly

MR. LOVETT. In the effort, if the Commission please, of counsel to try to select topics for this discussion, this was not mentioned as one of the subjects we would discuss. We would like to reserve the right to reply to the argument on that.

MR. SEVERANCE. That is all I have to say. That is the last.

Commissioner CLEMENTS. Yes; you will have that right and opportunity.

MR. SEVERANCE. I think I have covered everything I care to say, if the Commission please. My colleague will discuss the Chicago & Alton matter, and such matters as I have omitted; but this is all I care to discuss.

ORAL ARGUMENT OF F. B. KELLOGG, ESQ.,
Representing the Commission.

MR. KELLOGG. If it please the Commission, before taking up the Chicago & Alton, I wish to discuss for a few moments certain considerations advanced by the counsel for the Union Pacific road relative to the control by the Union Pacific of the Southern Pacific line and its effect upon competition.

Mr. Milburn particularly advanced three positions: First, that if this was in violation of law the Commis-

sion should not single out the Union and Southern Pacific for its consideration, but should embrace in its investigation all lines which control or seem to control or own any lines which are parallel, without respect to the time of their acquisition and to the years of their ownership and control; that if this control is void, this control of the Union Pacific over the Southern Pacific, then the Pennsylvania, the Lake Shore, and other railway systems have been and are controlling competing lines.

This argument is not new. Perhaps it is good; I make no argument to the contrary. I simply suggest that the dire results which are always predicted to follow these investigations, or the attack by the Government on a particular combination, do not seem to follow.

In the Northern Securities case it was said that if the control of the Northern Pacific and Great Northern was stopped, disrupted, it would be a great injury to the commerce of that great Pacific country and to the commerce of the Orient—which is not so important, but always seems to have fascinated the imaginations of men. But that result did not follow.

Mr. MILBURN. It was not changed, was it, Mr. Kellogg, in the slightest degree by the decision?

Mr. KELLOGG. If the Government had not stopped that control in its inception, in my opinion there would not have been to-day three independent lines of railroad in the United States. If it is possible by purchase of a bare majority or even a minority of stocks, as well as by organizing holding companies or financing companies, to control two, three, four, or five great systems of railways, of course it is possible, with reasonable capitalization, for a holding company to control all the lines of transportation in this country.

I take it that it is the policy of the people of the United States, as expressed in the enactments of Congress and of the States, that competition between lines of transportation, which are necessary to the development of commerce, which levy practically a legitimate tax upon all commerce to-day, shall be maintained.

Competition has three important aspects: First, com-

petition between lines of railway in the reduction of rates; second, competition in facilities furnished to the shippers, good transportation, quick transportation, ample transportation; third, and not less important, competition in the construction of additional railroads and branches, in the investment of the capital of railways and the use of their credit in the development of that great empire which lies beyond the Missouri River, much of it to-day demanding additional railway facilities.

I believe that any purchase or acquisition in any form or control by one corporation of the stocks of competing lines—any organization which can reach out and control the great lines of transportation in what is more than one-third, yes, more than one-half, of the United States to-day—is in violation of the spirit of the Sherman Act and in contravention of the policy of this Government and of the people as expressed in a hundred ways.

Now, what will the Government do? Will it permit it or will it stop it? It stopped it in the Great Northern and Northern Pacific case. It has stopped it in great industrial combinations in other branches of business, the encroachments of which threatened the industrial liberty of the people of the country.

Mr. Milburn says that this is an important matter. I do not deny it; it is of surpassing importance. Until we as a people abandon the principle of competition as applied to railroads or to industrial corporations, these questions must of necessity be important when raised as to any considerable industry or any considerable transportation line.

But is this, as counsel said, an insignificant and unimportant offender of the law? Is that true? Did not Mr. Harriman, in an almost boastful manner, state that he intended to get the Northern Pacific, if possible; that he would take the Santa Fe if the law would permit; that he would never stop as long as he lived if it was not for the law? Is the Union Pacific an unimportant offender? With between 2,000 and 3,000 miles of railroad and a capitalization exceeding \$500,-

000,000, it controls the Southern Pacific with 7,000 miles of road extending from Portland to New Orleans, with steamships from San Francisco to the Orient, and from New Orleans to Habana and New York. It controls the Oregon Short Line, the Oregon Railroad & Navigation Company, and the San Pedro Company, thereby controlling all the Pacific lines except the Santa Fe. It has a large ownership in the latter company, in the interest of harmony, which seems to have quieted the voice of competition in all that great southwestern country. The testimony shows that these companies have maintained rates; have divided traffic on a percentage basis; that they have joined in the ownership of new lines of railway north of San Francisco which are being constructed, vesting the alternate control one year in the Santa Fe and one year in the Southern Pacific, thereby eliminating competition in this territory; that the Union Pacific has a similar arrangement with the Rock Island for the control of the Alton, running from Chicago to St. Louis and Kansas City; that it has a large influence—probably a controlling influence—in the Illinois Central; a stock ownership in the Baltimore & Ohio, the New York Central, the Milwaukee & St. Paul, and the Chicago & Northwestern. Does the gentleman call this an inconspicuous offender? As one of the Commissioners remarked, “Is there no limit to this?” Are the people prepared to allow any one man, or set of men, through the organization of one corporation, with almost unlimited credit and means, to reach out, either by the acquisition or purchase of stocks in other companies, or through agreements or joint ownerships and management in the construction and operation of new lines, to tie up and control the transportation facilities of a great empire?

One further consideration upon that point. Mr. Milburn advances the proposition, which my associate has discussed, that that restriction upon competition which flows out of and follows the purchase of property is not prohibited by the Sherman Act. I shall not stop to discuss that at any great length. I take it, as I have stated, that the rule established by Congress is the

maintenance of competition, and that any restraint upon that competition is prohibited by the broad and general terms of the Sherman Act. The means are not important; the end is the all-important thing.

I take it the manner of restricting the competition of competitive railways is but the machinery by which the inventive genius of man has sought to evade the law. It may be by organizing a corporation, a holding company. That has been a favorite way of doing it. It may be by traffic agreements for joint control and operation, invented, I should think, by Mr. Harriman; at least, he has put it in force in the Alton, in northern California, and in the San Pedro. But the law looks through the means to the substance. Is it possible that the Northern Securities Company or any other company could not be organized to purchase or acquire or control or exchange its stocks for the stocks of competing railways because the power of control over those competing railways would tend to suppress or might tend to suppress competition, and that the broad general terms of the Sherman Act omitted the inhibition of the purchase outright by one competing line of the shares of the other competing line? Does that appeal to the judgment of men? I believe not as applied to railways, which are natural monopolies. But I believe, as applied to industrial corporations and to other corporations, that the means is not important; that the end is the important thing, and that if any person or corporation, by the purchase and acquisition of stocks of other corporations, yea, of the properties of corporations, seeks to and does suppress competition and monopolize and control the industries of the country, it comes within the inhibition of the Sherman Act and can be stopped by the courts. I think those principles are enunciated by the Supreme Court of the United States. I know they are the declarations of many of the State courts. You will remember that in the Distilling and Cattle Feeding case of Illinois the exact condition which the distinguished counsel named took place or was in existence. The Distilling and Cattle Feeding Company had purchased outright the prop-

erties of these various separate corporations for the purpose of suppressing competition and monopolizing commerce, and the supreme court of Illinois held it void. That decision has been cited and approved, and other decisions which my associate has mentioned have been cited and approved, by the Supreme Court of the United States.

But that principle is not necessary to this case, and I think much of this discussion my distinguished opponent would have better made in the Standard Oil Company case. It is unnecessary to the discussion of this question.

Mr. MILBURN. That will come in time.

Mr. KELLOGG. Quite likely.

Mr. MILBURN. Sufficient unto the day is the evil thereof.

Mr. KELLOGG. I believe, however, that as applied to transportation lines the principle has been settled by the Supreme Court of the United States, and the question is, Do the Union Pacific and the Southern Pacific come within the inhibition?

Now, one moment on the question of competition. I have explained my views on the elements of competition and the policy of the law. Were the Union Pacific and the Southern Pacific prior to the control by the Union Pacific competing lines within the decision of the courts and within the facts as proven?

Judge Lovett cited an act of Congress which he claimed made these connecting lines by force of law, and therefore permitted the purchase of the Southern Pacific by the Union Pacific—not only its shares, but the absolute entire corporate property. I am entirely familiar with the Pacific Railway act, and I presume your honors are. The object of the act was to obtain for the development of that country and the protection of the national domain, through, connecting lines of road, not only from the Missouri River to the Pacific Ocean, but connections with those lines which were then being constructed east of the Missouri River to Council Bluffs and Kansas City. The same act imperatively required the Union Pacific Railroad Com-

pany to connect with the eastern lines at Kansas City and form through lines to St. Louis, and to connect at Council Bluffs with all the lines running east across the State of Iowa and form through lines with the lines to the east. But has anybody ever claimed that the act of Congress—forcibly compelling the Union Pacific to make physical connection so that there could be through lines of transportation—permitted the connecting company to acquire the Union Pacific if west of there they were parallel and competing lines?

Mr. LOVETT. The act did not authorize them to consolidate with any lines east of the Missouri River, whereas this act expressly authorized the consolidation of the Central Pacific.

Mr. KELLOGG. I will come to that. It was the Central Pacific that Congress was legislating about, not the Southern Pacific, which the Central Pacific afterwards became a part of through the ownership of its stock by the Southern Pacific. Congress at that time was not considering a great transcontinental line, extending from Portland to New Orleans and New York; and the effect of that act can not be expanded beyond the railroad which Congress was then considering, and in any event, until that power of consolidation was exercised, it was subject to the legislation of Congress repealing it and invoking the Sherman Act.

No one denies that the Union Pacific can consolidate with the Central Pacific or purchase it, and I believe it would be a matter of public policy for it to do so. It would carry out the intention, at least, that the Congress then had in forming a great line of transportation from ocean to ocean. No one denies their right to consolidate or acquire stocks in connecting lines, however large they may be. It is the policy of the country and of the States to encourage connecting lines, and they should not be hampered in any way in owning stocks or securities or acquiring through lines of transportation, because that is in the interest of the shipper as well as in the interest of the railway company. But until the Congress changes the rule of competition, it is not

in the interest of the people and it is contrary to law to acquire competing lines and thereby stifle competition in all its aspects.

But the Supreme Court of the United States decided in the Northern Securities case that the Burlington was—and Mr. Lovett frankly admitted it was—a competing line with the Union Pacific. Was it less competing because it was a connection between Chicago and Omaha; because under the act of Congress the Union Pacific was required to connect with it at Council Bluffs, and because under another act of Congress the Burlington had the right to the use of the Union Pacific's terminals and depots and bridge at Omaha? Not at all. The court said it was obviously a competing line. It strikes the counsel as being obviously a competing line. And yet it is a connection between Chicago and the Missouri River.

Now as to competition. As I said, in the present condition of the ownership and control of railroads, with the possible exception of the Santa Fe, what competition is there west of the Missouri River on transcontinental business south of the Union Pacific road and between there and the Pacific Ocean? There is no competition in rates. Everyone knows that if the Southern Pacific, in order to increase its business, saw fit to make lower rates, the other transcontinental lines, the Union Pacific and the Santa Fe, would have to follow. Everyone knows that if the Union Pacific sought to do the same, even reducing its proportion of the through rate, the other transcontinental lines must follow. Community of interest, community of control by purchase of stock, eliminates that; and it is not in the interest of the owners to reduce rates of the two lines, when it might be of the one.

MR. LOVETT. Mr. Kellogg, do I understand you to say that if the Union Pacific had desired to reduce transcontinental rates by reducing its proportion it could have accomplished that?

MR. KELLOGG. Undoubtedly it could have accomplished it, unless the Southern Pacific should put up the rate.

Mr. LOVETT. Suppose the Southern Pacific should take out its joint rate with it?

Mr. KELLOGG. I do not think, under the law, it can do it. It can not to-day.

Mr. LOVETT. I am not speaking about the law to-day. I am speaking about it at the time this transaction occurred.

Mr. KELLOGG. I do not know about it then.

Mr. LOVETT. Whatever it is you must judge it by the law as it existed at that time.

Mr. KELLOGG. It could not prevent freight going by the Southern Pacific line onto the Union Pacific line, and if the Southern Pacific did not see fit to reduce its rate the Union Pacific could reduce its rate. The effect of competition in rates is done away with; the effect of competition in facilities, in construction of lines and the development of new country is done away with.

I go further than that. If it is possible that there is no such thing as a competing line in the larger, broader sense of these great transcontinental systems except those that are parallel and those that are complete from one terminus to the other—and both must have the same terminus—then there are few competing lines in this country; and two systems at least, if not one, could control all of the transcontinental business in America by one of them owning a link in the other. And I take it the business is competitive when from a large territory there is a considerable business which may go over either line at substantially the same rates, or the same rates, to and from any considerable country; and it is competitive in that larger and greater sense when from all the Atlantic seaboard it is admitted commerce may go by the Southern Pacific to Pacific coast terminal points or may go via rail lines and the Union Pacific, a link in a great transcontinental system.

Mr. LOVETT. Mr. Kellogg, if you do not object to my interrupting you—

Mr. KELLOGG. Certainly. Not at all, Mr. Lovett.

Mr. LOVETT. Don't you know that it is generally and universally recognized as a fact that the Southern Pa-

cific and the Atchison, between them, have always controlled the transcontinental traffic to and from California, in spite of all that intermediate lines could do?

Mr. KELLOGG. That is not my knowledge nor my experience—my limited experience—in traffic matters in that country. In fact, I am quite sure that during the days of the old pool prior to 1887 the Union Pacific was the big end of the transcontinental business and had 32 per cent of the transcontinental business as against 23 by the Sunset route, and that the Union Pacific has been one of the most important factors in transcontinental business. It is not my understanding that the Santa Fe and the Southern Pacific have controlled the situation. But if they had controlled the situation it is not necessary to wait until all competition is eliminated before the Government stops it. Otherwise a large part of the country might be deprived of the effect of competition in its business, while certain parts of it would continue to have it. It is not necessary to wait till they have controlled the Santa Fe and entirely eliminated that line from the situation, and it makes no difference in that commerce—transcontinental business, as commonly known by freight men—that between the Southern Pacific and the Union Pacific there is another transcontinental line. It is one less line for them to eliminate by the methods of ownership, control, community of interest, or harmony of management—call it what you will.

These seem to me to be self-evident facts. From all along the Atlantic seaboard the rates are the same and always have been, and it is not denied that a very large commerce may go to and from the Pacific Ocean over either the Southern Pacific, the Sunset route, or the Union Pacific, partly by its own line to Portland and partly by the Southern Pacific as a connection. And certainly you eliminate an important link with the power of the Union Pacific, with its mileage and its business—you eliminate that link from the transcontinental business, and you have suppressed competition to that extent.

Commissioner LANE. That argument goes to the extent of holding that the Lake Shore, as a part of the transcontinental route, could not own the Southern Pacific from New Orleans to San Francisco?

Mr. KELLOGG. Not necessarily.

Mr. LOVETT. Or the New York Central?

Mr. KELLOGG. Not necessarily at all. But I am willing to go that far if it is found that there is a substantial traffic which the New York Central and Lake Shore lines are engaged in as a link in the transportation across the continent, which the Southern Pacific and its connections by steamship are also engaged in. Because if you once permit an important link of 1,000 or 2,000 miles to be owned by a competing line, another link by another competing line, as I have said before and as you illustrated by your question yesterday, you can with two corporations eliminate all the others in the United States and control the transcontinental business.

Mr. LOVETT. The same people could not own the Lake Shore & Michigan Southern and the Louisiana Western Railroad. Is that the contention?

Mr. KELLOGG. I do not know that I know where the Louisiana Western Railroad is.

Mr. LOVETT. It is a part of the main line between New Orleans and San Francisco, a Louisiana corporation.

Mr. KELLOGG. I do not say that the link may not be so inconspicuous and so connected with other lines of road that it could be owned; but I do say that you can not take out of the transcontinental line a thousand miles of one of the principal railroad systems of the United States which connects with another and tie it up to a thousand miles south of it engaged in the same general business.

Now, is there a large business? Why, it was admitted that from all the territory west of Pittsburg to the Missouri River—all of that business, practically all of it—could go via the Southern Pacific and its rail connections or via the Union Pacific and its rail connections, and a certain amount of it to Colorado, which is

not an inconsiderable business, would not have to go over the Southern Pacific rails at all.

It seems to me that it is worthy of very careful consideration, for if it is possible that the Union Pacific road may take 5,000 or 6,000 miles, nearly 3,000 of which being a direct transcontinental line, and control it, it may also control the Burlington, because it has a few hundred miles of connections to the East. The Burlington might control the Union Pacific because it is a connection, and wherever the lines lap they can be controlled by a competing line. In other words, because the Southern Pacific extends farther east than the Union Pacific, it could go around the parallelogram and back half way to to the Pacific coast and control that part of the through line simply because they do not run in territory where as to local business they are competitive. The counsel narrows competition not to include the great transcontinental business, which is the principal business of these systems of railroad extending from the Missouri River to California.

I think I have made all the suggestions that I desire to as to that question.

I desire to invite the attention of the Commission to a question to which the counsel have devoted a good deal of time, and that is the Chicago & Alton Railroad.

MR. MILBURN. I think I have heard of it.

MR. KELLOGG. I think you have heard of it before.

MR. SEVERANCE. Mr. Milburn did not speak of it.

MR. KELLOGG. Now, I shall not attempt to follow the counsel in all of their analyses of the earnings; and the effect of the Chicago & Alton capitalization when made up on the theories of their various accountants on the basis of the dividends paid before and the basis of the dividends paid since. A railway accountant, or an expert accountant, however estimable and however much he may know about accounts, can take the books of any railway company and get a theory that sounds quite well. I shall content myself with narrating to this Commission, as nearly as I can, the cold undisputed facts which these gentlemen themselves

placed upon their own records, and which appear here undisputed. It is not that the Commission attacks securities that have been issued and are in the hands of innocent purchasers, or anything of that kind. I shall not devote any attention whatever to the question of whether, under the laws of Illinois, these securities now issued are or are not valid.

Now it appears that for many years before the road was acquired by this syndicate in 1899, Mr. Blackstone had managed the Chicago & Alton Railroad; that it had been exceedingly prosperous; that it had paid exceeding 8 per cent dividends to its stockholders; that it had a low capitalization; that it was a model railroad, as we all understood it in the West, in capitalization and in management. To be accurate, the book cost of the road, as it appeared by the books of the Alton Company, was \$34,153,927. It had other assets of a little over \$5,000,000. Its total capitalization, including stock, funded debt, and other liabilities, was \$33,951,407. It owned over 843 miles of railroad, 6,377 cars, 232 locomotives, and 148 passenger cars. In less than seven years these gentlemen had expanded that indebtedness, according to the last report of the Alton, to about \$122,000,000; but as it is claimed there are some duplications, I will take the lowest figures shown by these reports. They had expanded it to \$113,894,356, an increase of about \$80,000,000. And out of this increase they had spent upon the property but \$18,000,000, of which \$3,000,000 was for a railroad that the men who reorganized it sold to the Alton Company. In other words, they increased its liabilities about \$62,000,000 or \$65,433 a mile on 946.66 miles of road owned by the company, for which they did not give the company one dollar—not one dollar—of property or money expended.

Now, in all this time it had only increased its mileage 103 miles, and 58 of that was the \$3,000,000 road bought of Harriman and his associates; only increased its locomotives 18, its passenger cars 69; and its freight cars 3,730. I have no doubt it improved the quality of this equipment; but to say that it was necessary to expand the liabilities of this company any such

sum as that for the purpose of adding \$18,000,000 to a road which had a credit so good that its bonds then were selling on a basis of a little over $3\frac{1}{2}$ per cent, is to my mind incredible. I do not believe it. Why, the amount of money that these gentlemen added to this capitalization without giving it a dollar of assets is more than the capitalization per mile of the majority of the great western lines of road—the Milwaukee, with \$32,000 and a little over per mile; the Northwestern, with \$32,000 per mile; the Burlington, about the same or a little more; the Rock Island, \$45,000; the Great Northern, \$38,000. Of course there are other roads in the United States that far exceeded that.

It is said they spent \$22,000,000. They did not spend \$22,000,000 out of this expanded capitalization. Mr. Harriman said they had spent \$22,000,000. On cross-examination he admitted his figures were given him by Mr. Felton and that he did not personally know anything about it, except in a general way. When Mr. Felton went on the stand he said that from the day these gentlemen took hold of the road down to the present time, this winter, the company had (including the 58 miles of road they bought) expended \$22,327,219.04, but that \$2,708,000 was equipment trust notes not included in this capitalization made since July 1 last, and \$1,000,000 was taken out of earnings and not included in this capitalization. So that, according to his figures, it would be \$18,547,219. I said about \$18,000,000, for the reason that Mr. Mahl, the comptroller of the Union Pacific road, added this clause to Mr. Hillard's statement, Mr. Hillard now being the comptroller of the Alton road, and that statement was that they added but about \$18,000,000, and he was about right.

Now, I am not saying that other roads have not expanded their capital. I am saying that this one has. I am simply saying that this is an example which the Commission should consider when it considers the question of what recommendations it shall make to Congress to prevent the recurrence of such finance. That is all.

Commissioner CLEMENTS. To what extent can you locate the proceeds of this capitalization beyond what you say was applied to the railway?

Mr. KELLOGG. It is all perfectly located by these statements, which are in evidence, and I think I can tell the Commission substantially.

What is this capitalization and for what was it spent? It is admitted that at the time this road was recapitalized or reorganized it had a bonded indebtedness of about eight and a half million dollars. The report of the Alton—the last one made by Mr. Blackstone, I believe in 1898—showed that these bonds were short-time, high interest-bearing bonds. They were bonds which matured a few months less than three years thereafter, some of which were selling in the market at a rate to yield $3\frac{1}{2}$ per cent, substantially all of which might have been retired within the next three years, and a number of them within a few months. With the credit of that line of railroad it stands undisputed that it might have sold its 4 per cent bonds at par, and instead of increasing its fixed charges from \$1,000,000 to over \$2,600,000 per annum, could have made all of these improvements by increasing its interest account \$720,000 or \$750,000.

From this report for 1898 it will be seen that \$1,785,000 of the Louisiana & Missouri River Railroad first-mortgage sevens matured August 1, 1900, within a year after they sold these \$40,000,000 or \$32,000,000 of bonds they put upon the road; of Louisiana & Missouri River Railroad second sevens, \$300,000 on November 1, 1900; \$1,695,000 of the Chicago & Alton sinking fund sixes, May 1, 1903, and \$4,379,850 of Chicago & Alton sixes, July 1, 1903.

These included all of the bonds except \$491,000, making a total of \$8,159,850 in bonds.

Now, what did they do? Mr. Harriman, Mr. Schiff, Mr. Gould, and Mr. Stillman bought the control of this stock. But, says Mr. Lovett, Mr. Harriman should not be blamed for all of this. I am not blaming Mr. Harriman any more than the rest. He has assumed the responsibility for it; I will say he has not shirked it, and he said there were others interested. The records

show that the four men bought all of the stock except 73 shares of the preferred stock and 4,287 shares of the common stock. When Mr. Harriman was asked who the syndicate was and who the syndicate managers were, he did not know. He could not tell any of them. If he wanted to show the list, why didn't he do it? But it does not make any difference whether he represented himself alone or the other gentlemen with him, or whether, after they had formed this syndicate, they sold certificates to 100 or 200 men. It does not appear that these men were interested in the purchase or whether they became interested in the syndicate certificates. I do not think it is material as to the facts one way or the other. We are looking into the capitalization, and I do not care who the individuals were. Mr. Harriman is an incident simply of a transaction which you gentlemen are looking into among other transactions in railroad finance.

What became of this \$40,000,000 of bonds? Immediately after they acquired this stock they placed a \$40,000,000 3 per cent fifty-year mortgage upon the property. It does appear, and could not appear in any other way, that if the Chicago & Alton Railroad stock was worth \$39,000,000, its 3 per cent bonds were worth more than 65. They certainly sold for about two years at 90 or above, or substantially that, and they certainly could have borrowed all the money the Chicago & Alton wanted at 4 per cent. To take up the eight million six hundred and some thousand dollars of prior mortgage bonds and the interest and for other corporate purposes, this mortgage was placed upon the property. They sold through Kuhn, Loeb & Co. to Goldman, Sachs & Co., who sold then to the New York Life \$10,000,000 of these bonds at 96 cents on the dollar.

It appears by the testimony of Mr. Harriman and the exhibits that \$10,000,000 of these bonds were sold, all of them, in October, November, and December, 1899. The first \$4,000,000 were sold on the 17th of October. They provided for the issuance of these bonds on the 30th of June. The stockholders—these four men who owned substantially all the stock—agreed to take them

at 65 per cent on the 7th of September. They got the first \$10,000,000 authorized on the 10th of October, and on the 17th they sold to the New York Life Company at 96. Now, Mr. Harriman said there was a great change in the market between June and October, but when he came to be examined and confronted with the Financial Chronicle, showing the sale of bonds, the change was the other way. The bonds were selling lower in October than they were in the previous June and May. That appears undisputed.

What was the average price of these bonds? I do not know what they got for them other than what here appears. They know, and it seems to me if they wanted to show it they could have done so. But I am simply taking the record, their own figures and the figures showing the price received for these bonds in the market for the next two or three years. It does appear that the \$10,000,000 not only sold for 96, but that Kuhn, Loeb & Co. sold \$1,000,000 to the Equitable Life Insurance Company in 1901 at 92 and \$550,000 in 1902 at 88, so that for nearly three years—over two years—these bonds sold between 88 and 96. As a matter of fact, during the months of October, November, and December of 1899, all of 1900, and January, February, and March of 1901, these bonds never went below 92½.

Now, those men, according to these market prices, could have sold those bonds at 90. Why, the Alton bonds were then selling in the market on a 3½ per cent basis, according to the Financial Chronicle, which is in evidence; and Union Pacific fours, the Northern Pacific fours, and other high-class railroad first mortgage 4 per cent bonds, with no better credit than the Chicago & Alton, were selling in this country above par. We do not deny that at times railroads can not do that, and they can not do it now; but they could have done it then, and the Alton had exceptionally fine credit. It was, in fact, a shining mark.

Even had these 3 per cent bonds been placed on a 4 per cent basis they would have sold at 78.45—that is, placed on a basis that they would produce during the fifty years 4 per cent. But they were sold to these

gentlemen at 65. No amount of explanation will show that to be good conservative railroad financing, and it is no answer to say that it was done in other railroads. It was certainly done in this.

But what became of the proceeds? Before I go on I might mention, to show that these bonds have always sold above 65, that Kuhn, Loeb & Co., on March 31, 1905, sold \$2,000,000 of them for 83½, and \$3,000,000 on July 31, 1905, for 83¾; so that there never was a time when these bonds did not sell in the market above what these gentlemen took them at.

That is not all. I think I have a right to bring to the attention of the Commission two circumstances, which do not commend themselves to conservative management. One is that shortly after the purchase of this stock these gentlemen paid to themselves a dividend of 30 per cent out of the proceeds of this mortgage. They owned all the stock except 73 shares of preferred and 4,287 shares of common. They controlled the company. If you deduct this dividend which they took out of the mortgage, they really paid about 48 or 49 cents on the dollar for the bonds.

The fallacy, it seems to me, of Judge Lovett's argument that a road should be judged by what it has paid out in dividends and interest is this: He said, "We haven't paid out in dividends and interest much more since the reorganization than was paid out before." But remember that Mr. Blackstone was paying his stockholders 8 per cent dividends, while the reorganized Alton was only paying 4 per cent on its preferred stock and nothing on its common.

Furthermore, the time may come when the Commission would say that 8 per cent dividends was rather large, if dividends are to be taken as the basis for rate making. I do not say whether it is or not. A railroad should have good earnings. Dividends should not be small. It is not in the interest of the country to make rates so low that railroad securities, which form a large part of the wealth of the people, should not receive a reasonable income, and should be depressed.

If the Commission and the country have no interest

at all in investigating the question of overcapitalization, if they have no interest in the stability of securities placed on the market in which people invest their savings and which they buy on the faith of the security, then perhaps Judge Lovett's theory is correct, that the amount of the securities issued is entirely immaterial. I prefer to adopt Mr. Cravath's suggestion that the people have an interest in this, and that there should at this day be reasonable regulations which will insure the stability and the safety of railroad securities and make them a desirable investment.

I do not deny that in the construction of new lines of railroad, especially into new country, it has been necessary to issue bonus stock and sell railroad securities much below par. I do not deny that this has tended to develop the great western country, to furnish it lines of transportation, and to add millions to the wealth of the nation. But I believe the time is coming when Congress should reasonably limit the inflation and manipulation of railroad securities, in order that their stability may be insured and their value maintained. Investors can not inquire into the history and value of the property and the basis of credit of all railway securities; they must accept them on the faith of their earning capacity and the integrity of the management. This regulation should not be unreasonable. It should not hamper the capitalization or the increase of capitalization of railways; it should not retard the construction of new lines, and the development of the country; but it should prevent great railway systems, which are to-day reasonably capitalized and have high credit, from being shining marks of manipulation in Wall street or any other financial market. That is what I say.

The entire country is interested in the stability of these investments. It should be a matter for serious, not hasty, consideration. Reasonable regulations should be made to prevent the recurrence of such a system of overcapitalization. No excuse can be given for taking a railroad with a capital that is small, with credit established, which is in a position to extend its lines, to make additions, acquire equipment and terminals

necessary to do the business of the country, and swell its capital, thereby discounting the future merely for the purpose of making a profit.

Judge Lovett produced some figures which I shall not stop to comment on to any very great extent. Figures always confuse me. But he credits against the cost of this property the \$32,000,000 of bonds at 80. We have shown that for nearly two years they sold for over 90.

Mr. LOVETT. It is merely to show what it cost them, what it stood them in.

Mr. KELLOGG. I understand that, Mr. Lovett; \$22,000,000 of $3\frac{1}{2}$ per cent bonds—\$16,500,000 at 75—and they sold for years between 80 and 87 and 88; \$20,000,000 of preferred stock at 77, and the Union Pacific paid 86 within the last two years.

Made up on the basis of \$32,000,000 of bonds at 90, and the \$22,000,000 of bonds at 85, and the \$20,000,000 of preferred stock at $86\frac{1}{2}$, and the common stock at 38, which was the fair average price for two or three years afterwards, these gentlemen would have made sixteen and a half millions instead of the hypothetical sum which Judge Lovett figures out this capitalization showed.

But that is merely a side issue. I am showing what this capitalization was used for, and whether the Commission should consider this, with all the other facts it has, and its knowledge generally of railways and capitalization, in making any recommendation on the question of the capitalization of railways in the future.

There is another thing the Commission should consider, and that is the system of bookkeeping by railroads. What becomes of these dividends? Why, the counsel says they were openly, notoriously paid. Nobody denied it. But I think the law requires that dividends should be reported to this Commission in the annual reports; and that 30 per cent dividend, I am informed, was never reported to the Commission. It is not in the annual reports to the Commission at all, and not shown. The \$8,150,000 of discount on bonds is not shown in the reports to the Commission

or in the annual reports of the company; and Mr. Hillard says they were charged against this \$12,444,-176.66, which was expenditures uncaptalized, in order to cover it up.

Mr. CRAVATH. Are you speaking of the discount on the bonds?

Mr. KELLOGG. Yes. Whether that was the reason or not——

Mr. CRAVATH. He did not say it was done. He said he thought it would have that effect.

Mr. KELLOGG. He said he thought it would have that effect.

Mr. CRAVATH. He did not say it was done.

Mr. KELLOGG. Perhaps he did not say it was done, but he stated it would have that effect. [Reading:]

“Mr. KELLOGG. But charging the discount on bonds against this would cover it up on the books, would it not?”

“Mr. HILLARD. Yes.

“Mr. KELLOGG. It would tend to obscure it, would it not?”

“Mr. HILLARD. Yes; so far as the public were concerned.

“Mr. KELLOGG. It would cover it up, so far as any man looking over the books was concerned?”

“Mr. HILLARD. No; any man looking over the books would see it, but any man looking over the annual reports would not.”

Of course the public do not look over the books. They look over the annual reports.

“Mr. KELLOGG. Would not see it?”

“Mr. HILLARD. No; he would not.

“Mr. KELLOGG. That is what I thought. Then, so far as the annual reports made to the stockholders or the public is concerned, they would not see that?”

“Mr. HILLARD. No; they would not see that.”

That is what he said.

What is this \$12,000,000 that so much has been said about? In the report of 1899 to the Interstate Commerce Commission there appears an item credited “Construction expenditures uncaptalized, \$12,444,-176.66.” What was that? These gentlemen went back into the history of the Alton road; they took the report made ten years before by Mr. Blackstone to his stock-

holders, in which, with commendable pride, he pointed out to them that the Alton road was worth at least \$11,000,000 more than it was capitalized for, owing, partly at least, to the losses of the original stockholders of the old Joliet and Chicago road, which had been foreclosed way back in war times before 1863. And I believe that this is the first time I have ever heard of waiting thirty years and recapitalizing losses of stockholders of another road made in foreclosure proceedings years before. That looks to me somewhat like robbing the graveyard.

Let us see whether I am correct in that. I would like to call your attention for a moment to Mr. Blackstone's report of 1898. Well, I will find it in Mr. Hariman's testimony, page 66. Here is what Mr. Blackstone says:

"Taking into account the loss sustained by the original corporations which constructed that part of your lines between Joliet and Alton and operated it until it passed from their hands to yours by foreclosure and sale under the original mortgages, and the amount which your company has expended for additional property not represented by stocks or bonds, we find not only that your company has never issued a share of stock or an obligation of any kind that did not represent at its par value an equal amount of cash or its full equivalent of property at the time actually received, but also that the original cash cost of your property, as nearly as it can be ascertained, was \$10,989,878.15, or, in round numbers, \$11,000,000, more than the par value of the total amount of stocks and bonds which your company has issued or assumed.

"To ascertain the difference between the original cost of your property and the amount of stocks and bonds for which your company is responsible now outstanding, \$725,000 should be added to the amount above stated, being the amount of bridge and sinking-fund bonds since paid and canceled, in place of which no stock or bonds have been issued."

In other words, they paid their debts and canceled the bonds; and these gentlemen took the losses of the original stockholders, money expended twenty or thirty years ago and charged off, and bonds paid and canceled, as the starting point of their recapitalization of the Chicago & Alton Railway.

I will go further than that. I say that they not only did that, but they took from that time on the annual appropriations made by the board of directors—who had it in control, and who were entitled to speak and had the authority to charge it off—they took the annual sum for ten years which had been spent in betterments and improvement of that property to keep it up to the standard to which Mr. Blackstone thought it should be kept up, and they took that and added it to the \$11,000,000 and made \$12,444,176.66.

I would like to refer to the details of that, because I believe that that sort of bookkeeping is not lawful. I do not mean that it is criminal; I mean that it is not lawful, in that the board of directors had disposed of it and no subsequent board of directors had a right, in my opinion, to repeal those resolutions, to dig up those amounts, add them to capitalization, and pay it out in dividends, or charge it to discount on bonds.

On pages 204 and 205 of the exhibits of Mr. Hillard, who is now the comptroller of the Alton, will be found the items of those sums, and from 1889 down to 1898 the annual sums appropriated were charged off. I have all the reports here. I will not stop to read them, but I will give the Commission an illustration. For instance, in the income account, after the payment of the interest on the funded debt and the dividends and the rentals each year, the company made this charge: "Appropriated from this account for additional property, real estate, and new tracks, \$18,764.71." Some years it was more; one year it was \$238,000; one year it was \$32,000; another year, \$26,000. I am giving round numbers. Those sums had been annually appropriated.

Now, I deny the right of any subsequent board of directors ten years later, or any time later, after the board of directors has passed on that question, to take all those sums and capitalize them and pay them out in dividends. We all know that every railroad which is kept up to the standard it ought to be, must spend a large sum of money in betterments which are not strictly new construction and should not be charged to capital account. Railroads must be maintained, and there is not a well-managed railroad in the United

States that undertakes to capitalize every dollar spent for betterments. Every well-managed railroad capitalizes certain amounts—new construction, usually double tracking, sometimes additional weight of rails—but I think the conservative men will admit that it is necessary every year to spend a large sum of money which is in the nature of betterment of property, in order to keep it up to the standard; because otherwise, if you capitalize every dollar, the time will come when your indebtedness will break any road in the United States.

At least I deny that it is conservative railroad management to go back thirty years, take the losses of the original stockholders, take all the money used during those years for the improvement and betterment of the railway, and charge them up as a part of the capital account, borrow money on a mortgage to pay it back to the railway company, and then turn around and pay it out to themselves in dividends and in profits on bonds sold to themselves at unreasonable and absurdly low prices.

Against that \$12,444,177 they charged this dividend of \$6,669,180, and \$8,155,751 of discount on bonds. Now, what was that? It was not the discount on the \$32,000,000 of bonds at 35, which would be the ordinary way. I have never known—I am not an expert in railroad accounting, but I have never before known discount on bonds to be charged in that way. But \$8,155,000 for some reason seems to have been charged as discount on bonds, as against \$12,444,000—I can not for the moment think for any other reason than to cover it up. That probably, I suggest, may have been profits to these gentlemen on those bonds. Whether it was or not, it is certainly a discount on bonds charged against a raked-up old account of the Chicago & Alton for construction expenditures uncanceled and losses of prior stockholders.

MR. CRAVATH. Is it quite fair to call it a raked-up account, inasmuch as the Blackstone management agreed upon the advisability of carrying those expenditures to profits? I object to the characterization; that is all.

Mr. KELLOGG. I think it is fair. I do not care what Mr. Blackstone said he was going to do about making some stock dividends. My recollection is that this was said by Mr. Blackstone in the circular—and I am perfectly willing that the circular should be given to the Commission—to prevent their selling out this stock to Mr. Mitchell, who turned it over to Mr. Harriman, Mr. Schiff, Mr. Gould, and Mr. Stillman.

Mr. CRAVATH. That was the time.

Mr. KELLOGG. That was the time. Mr. Blackstone was opposed to it, and he did send out a circular. I am not sure whether it is in evidence or not, but I am not traveling out of the record more than the other gentlemen.

Mr. CRAVATH. He said the price was not high enough.

Mr. KELLOGG. He said the price was not high enough; and he said everything he reasonably could to prevent the stockholders selling him out and turning him out of the road. He said that he would distribute a stock dividend; but even a reasonable stock dividend to his stockholders who had owned this property all those years, while it might not have been legal, and while I would not justify it at this day, was nothing to compare to the expansion shown by this transaction.

A few words more on that point. These gentlemen, having bought the Chicago & Alton Railroad stock, organized the Chicago & Alton Railway Company. They placed their stock in the treasury and they mortgaged it for \$22,000,000. That transaction took this form—and I do not deny that it is a form which is sometimes used in transferring property into a railroad in order to get out the securities—but it did take this form. These gentlemen transferred their stock to Mr. Louis Stanton and transferred, or at least nominally transferred, this 58 miles of road to Mr. Stanton. Mr. Stanton made a proposition to the new Chicago & Alton Railway Company to sell it 34,722 shares of preferred stock, which had cost them \$6,944,400, and on which they had received a dividend of \$1,041,660, leaving a net cost of \$5,902,740—they proposed to sell that to the new company for \$10,000,000 in cash. The 183,224 shares of common stock which they had bought, which had cost

them \$32,064,200, on which they had received a dividend of \$5,496,720, they proposed to sell to the new company for 390,318 shares of its stock, one-half of which was preferred and one-half common. It does not appear what these gentlemen got for their common stock or their preferred stock, but if they sold it for anywhere near the market price, as shown by the table which Mr. Lovett put in evidence, they must have made a very large profit on this transaction.

Mr. SEVERANCE. When was the 30 per cent dividend?

Mr. KELLOGG. It was paid May 9, 1900.

Mr. SEVERANCE. Here is the report for the year ending June 30, 1900.

Mr. KELLOGG. Mr. Severance calls my attention to the fact that the annual report to the Commission shows 7 per cent paid on the common stock and $8\frac{3}{4}$ on the preferred stock of the Chicago & Alton Railroad Company and no 30 per cent dividend. That certainly was a little irregular.

Mr. SEVERANCE. The year before it was $5\frac{1}{4}$ per cent on each.

Commissioner LANE. That report is not sworn to, is it?

Mr. KELLOGG. Yes, sir. The reports are sworn to by the comptroller, I think, or somebody.

Mr. CRAVATH. Who made the reports?

Mr. KELLOGG. It is made by the Chicago & Alton Railroad Company.

Mr. CRAVATH. Who was the auditor?

Mr. KELLOGG. I do not know. I will have to see.

Mr. CRAVATH. Never mind.

Mr. KELLOGG. I am not sure it is sworn to, either. And it is possible, I say, some other report may show it.

Mr. SEVERANCE. The year before it is sworn to by Charles H. Chappell, vice-president, and Charles W. Davis, auditor.

Mr. KELLOGG. Now, they were to get \$10,000,000 for this stock and they were to get \$3,000,000 for the railroad, making \$13,000,000; and the records show they sold the \$22,000,000 of bonds for \$13,000,000. But, as a matter of fact, they transferred all the stock and all the bonds for the securities.

Mr. CRAVATH. That is the practical effect.

Mr. KELLOGG. That is the practical effect. But the bonds, if sold for \$13,000,000, would be a little less than 60 cents on the dollar, and they never sold thereafter at anywhere near that low price; in fact, they averaged from 1900 down to the present time from $76\frac{1}{2}$ to $86\frac{1}{2}$, and during the two or three years after their issue they sold for $82\frac{1}{2}$ to 86.

There was the issuance of \$40,000,000 of common stock and \$22,000,000 of bonds which have been put on the market in addition to the \$40,000,000 of bonds, much of which was an increase of the capitalization of this company.

There is another item that I wish very briefly to call to the Commission's attention, and that is the item of \$973,477 of funded interest account which was added to the capital of this road. That mortgage was made to take up the prior bonds and coupons. From June, 1901, down to 1906, there was carried in the treasury of the Chicago & Alton company \$973,477 worth of the coupons of its prior mortgage bonds which had been paid. It was carried as an asset in the treasury of the Chicago & Alton company. I take it that coupons from the bonds paid with that mortgage should have been canceled, and were not legitimate assets in the treasury. As a matter of fact, in 1905, after having carried them for four years as an asset, they were charged to capital account.

Again, it may not have been illegal, but it was bad business to mortgage that 34 miles of road in process of construction, sell all the bonds, and leave no way of raising funds to complete it.

Mr. CRAVATH. To build that road?

Mr. KELLOGG. To build that road; yes. As a matter of fact, when the new management took hold of the Chicago & Alton company what was its condition? After having expanded its securities from \$33,000,000 to \$114,000,000, and only having spent \$18,000,000 on the property, it found itself confronted with the necessity of buying additional equipment, and was compelled to issue \$2,780,000 of trust certificates to do so.

It was reduced to the necessity of giving its equipment notes in order to obtain the facilities with which to serve the public. Not only that, but it had no money in the treasury, and no way of raising money, to complete the 34 miles of road in process of construction. Here was the Alton company, with all its splendid credit, in six years of prosperous times, unable to meet its demands, after this enormous recapitalization, made (as Mr. Harriman said) to meet modern conditions.

Now, I deny the necessity, I deny the morality, and I deny that it is good financiering, whether it was within the law or whether it was not. I believe this is a most conspicuous instance of taking a railroad with a splendid credit, with low capitalization, making it the object of speculation, for the purpose of increasing its securities and unloading them on the public for the purpose of enriching the managers, when the earnings of the road do not and can not justify the increased capitalization. I deny that it is necessary, and I believe the law should not permit such transaction; that the law should require that money borrowed be used for corporate purposes of construction and acquisition of the property, improvement of the railway, or the funding of prior indebtedness, and that reasonable restrictions should at this date be placed upon the unlimited issue of securities of railroads.

One other suggestion. I do not believe that it is wise, as I said before, that unreasonable restrictions should be placed upon the acquisition of stocks and securities of connecting railways; but I do not believe it is in the interest of the railways themselves, or of the public, that they should be allowed to become great financial investment institutions, dealing in the stocks and securities of other railways. Their credit should be used in the expansion and development of their lines in the transportation business of the country. Their securities should return reasonable and generous dividends. Their credit should be of the highest. I should deplore action or legislation which would hamper them or show an unreasonable spirit toward their expansion, for the expansion of the railway systems of the country must go hand in hand with its prosperity and its

development. But I do not believe that the enormous credit of railway companies should be used for the purpose of purchase and sale of securities of other lines or used for other than transportation business, and that their solvency should not be imperiled by the rise and fall in the prices of stocks.

Mr. LOVETT. Just one word, if the Commission please. I did not know how far Mr. Severance expected to go in his discussion of the purchase of the stocks of the road; but, stopping where he did, I really have but a few words to say.

No one has suggested that those purchases were illegal. I do not understand that he is now contending that they were, but he is making a suggestion that it might be proper for Congress to prohibit such purchases in the future. In that view of it, that is a question which I do not care to discuss. It is a legislative and not a legal question. Whether Congress has that power or not is a very grave question, and I may say for myself that I do not believe it has any such power. It would involve a change in the structure of this Government. But that is a question which I do not care to discuss.

The purchases were simply in the exercise of unquestioned powers conferred upon these corporations by the States that created them, and there is no law of Congress that forbids it as yet. That is the only interest that we have.

Commissioner CLEMENTS. Is there any further argument to be offered by anyone?

Gentlemen, we are very much obliged to you for the full and fair manner in which you have discussed this matter before the Commission, and we have followed it with a great deal of interest. The matter is now at a point where the Commission will take it under consideration, subject to any future order it may make in the premises. With that understanding, we stand adjourned.

The Commission thereupon, at 4.15 p. m., adjourned.



